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**Royal Economic Society 2010 Conference**  
**Complete List of All Session Abstracts**

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## **Session 1: Economics of Health**

**Session Chair: Jonathan James, University of Essex**

**Room: 03 MS 01**

**Date: March 29, 2010**

**Time: 13:30 - 15:00**

### **"Honey, why don't you see a doctor?" - Spousal impact on health behavior**

**Presented by: Stefanie Neimann, TU Dortmund, RGS Econ** (Hendrik Schmitz, Ruhr Graduate School in Economics and University Duisburg-Essen)

Married individuals are usually found to be in better health than singles but it is not fully understood why. Using data from the German Socioeconomic Panel we test one possible explanation, namely that two spouses encourage each other to a health-promoting behavior and monitor it. Therefore, we analyze the direct spousal impact on seeking medical advice, physical activity, and eating habits controlling for positive assortative mating and shared unobserved environmental influences. While we find no causal effect regarding a health-conscious diet, the impact of the partner's doing sports is substantial. Moreover, females affect their male spouses in seeking medical advice but not the other way around. The latter result may explain why men usually benefit more from marriages than women.

### **From Angela's Ashes to the Celtic Tiger: Early Life Conditions and Adult Health in Ireland**

**Presented by: Mark McGovern, UCD** (Liam Delaney, UCD and James P. Smith, Rand Corporation)

Economists are increasingly focusing on the role of early life conditions in determining adult outcomes. We use data from the Irish census and exploit regional and temporal variation in infant mortality rates over the course of the 20th century to examine the effect of early life conditions on later life health. Our main source of identification is a series of public health interventions, centered around the 1947 Health Act, which eliminated the Irish urban mortality penalty. Estimates imply that the fall in national infant mortality during the 1940s reduced the current rate of Irish disability by around 10 percent. There is also evidence that individuals from lower socio economic groups benefited most from these improvements in infant health.

### **The Effects of the War in Iraq on Nutrition and Health: An Analysis Using Anthropometric Outcomes of Children**

**Presented by: Gabriela Guerrero-Serdan, Royal Holloway/Yale University**

The war in Iraq initiated in March 2003 triggered a wave of violence and turmoil in the country. The level of violence has varied across provinces, the south and centre areas being the most affected. Using the different intensities of the conflict across areas and the age at exposure to the war among cohorts, I analyze a possible causal effect of the war on nutritional outcomes of children. Estimates indicate that children born in areas affected by high levels of violence are 0.8 cm shorter than children born in low violence provinces. The paper also addresses the channels through which the conflict has affected health and nutrition.

### **Healthy School Meals and Educational Outcomes**

**Presented by: Jonathan James, University of Essex** (Michele Belot, University of Oxford)

This paper provides quasi-experimental evidence on the effects of diet on educational outcomes, exploiting a campaign in the UK in 2004, which introduced drastic changes in the meals offered in the schools of one Borough – Greenwich, shifting from low-budget processed meals towards healthier options. We evaluate the effect of the campaign on educational outcomes in primary schools using a difference in differences approach; comparing educational outcomes in primary schools (key stage 2 outcomes more specifically), using the neighbouring Local Education Authorities as a control group. We find evidence that educational outcomes did improve significantly in English and Science. We also find that the campaign lead to a 15% fall in authorised absences – most likely linked to illness and health.

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## **Session 2: Inflation Targeting and Central Bank Behaviour**

**Session Chair: Jaromir Baxa, Academy of Sciences of the Czech Rep.**

**Room: AP1**

**Date: March 29, 2010**

**Time: 13:30 - 15:00**

### **Credibility in emerging economies: Does inflation targeting matter?**

**Presented by: Matteo Lanzafame, Università degli Studi di Messina** (Reginaldo P. Nogueira Jr; Escola de Governo, Fundação João Pinheiro, Brazil)

This paper evaluates the role of inflation targeting (IT) in enhancing monetary policy credibility in emerging economies. We construct a time-varying credibility index, and then carry out extensive testing in order to assess whether IT had a significant impact on monetary policy credibility. Our results confirm that credibility was on average lower for targeters than non-targeters before the regime change, and show that the gap was closed after the adoption of IT. However, taking mean-reversion into account, we find no significant evidence that IT bolstered credibility levels.

### **Inflation Targeting, Coordination, and Confidence Crises**

**Presented by: Rafael Santos, Central Bank of Brazil** (Aloisio Araujo ; IMPA and GV Foundation (EPGE))

The announcement of a low target fully supported by strong fundamentals can properly anchor the inflation expectations. However, since the public understands that not only announcements but also fundamentals drive expectations, an ambitiously low target may not be useful in coordination efforts. The complementarity between agents' and central bank's decisions might lead to coordination failure when the target depends also on agents' decisions to be supported. To tackle this issue, we propose a global-game framework. In a favorable equilibrium, we find that ambitiously low target level could properly anchor expectations when public and private information are extremely accurate. Generally, good coordination requires a prudent target.

### **What is the ECB Reaction Function? A Static and Dynamic Probit Analysis**

**Presented by: Carlo Rosa, University of Essex**

We propose a dynamic ordered probit specification of discrete changes to model the ECB policy rate. We find that interest rate decisions are closely tied to business and consumer surveys rather than to the real time estimate of the output gap. Contrary to the previous literature, we show that once the econometric model is correctly specified the ECB also reacts to inflation shocks, especially core inflation and inflation expectations rather than realized headline inflation. Formal model comparison based on Bayes factors provides decisive evidence that the dynamic probit model better takes into account both the discreteness and the serial correlation displayed by policy rates compared to a standard ordered probit specification.

### **How Does Monetary Policy Change? Evidence on Inflation Targeting Countries**

**Presented by: Jaromir Baxa, Academy of Sciences of the Czech Rep.** (Roman Horváth, Czech National Bank and Institute of Economic Studies, Charles University, Prague and Bořek Vašíček; Universitat Autònoma de Barcelona)

We examine the evolution of monetary policy rules in a group of inflation targeting countries (Australia, Canada, New Zealand, Sweden and the U.K.) applying a time-varying parameter model with endogenous regressors. Our main findings are threefold. First, monetary policy changes gradually pointing to the importance of applying time-varying framework. Second, the interest rate smoothing parameter is much lower than what previous time-invariant estimates of policy rules typically report. Third, contrary to common wisdom, the short-term response of interest rates on inflation becomes less aggressive after the adoption of inflation targeting suggesting the positive effect of this regime on anchoring inflation expectations.

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## **Session 3: Innovation and R&D**

**Session Chair: Christian Helmers, University of Oxford**

**Room: AP 2**

**Date: March 29, 2010**

**Time: 13:30 - 15:00**

### **Semi-Public Contests**

**Presented by: Jens Prüfer, Tilburg University**

The process of innovation is driven by two main factors: new inventions and institutions supporting the transformation of inventions into marketable innovations. This paper proposes a new institution, called a semi-public contest, that has been neglected by the economic literature but exists frequently in practice. I show how semi-public contests can mitigate a dilemma that arises at an early stage of innovative activity and specify the conditions under which a semi-public contest can increase welfare. The results suggest that governments promote knowledge about the semi-public contest mechanism but refrain from direct public funding of contests.

### **Innovation-Specific Patent Protection**

**Presented by: Angus Chu, Academia Sinica** (Guido Cozzi, University of Durham and Silvia Galli, University of Durham)

This study develops an R&D-based growth model that features both vertical and horizontal innovation to analyze the current debate on whether patent protection stimulates or stifles innovation. Specifically, we consider the growth and welfare effects of patent protection in the form of profit division between sequential innovators along the quality ladder. We show that patent protection has asymmetric effects on vertical innovation (i.e. quality improvement) and horizontal innovation (i.e. variety expansion). Maximizing vertical (horizontal) innovation requires a profit-division rule that assigns the entire profit to the entrant (incumbent) of a quality ladder. Therefore, we argue that to understand the growth and welfare implications of patent protection, it is important to firstly disentangle its different effects on vertical and horizontal innovation.

### **Simultaneous Product and Process R&D Choices Over Time: A Welfare Analysis**

**Presented by: Souresh Saha, Brunel University**

In this paper, I compare simultaneous product and process R&D choices over time of a profit-maximizing firm to those of a welfare-maximizing firm. I find three results. First, I show that a welfare-maximizing firm does relatively more of process R&D over time. This is qualitatively similar to the choice by a profit-maximizing firm. My second finding is that in a second-best welfare comparison, the profit-maximizing firm chooses the same amount of process but a lower amount of product R&D in every period. Moreover, the extent of inoptimality of product R&D increases over time. Third, a general R&D subsidy to a profit-maximizing firm increases its product R&D but also results in the firm undertaking more process R&D than is optimal.

### **The Effect of Market Entry on Innovation: Evidence from UK University Incubators**

**Presented by: Christian Helmers, University of Oxford**

This paper investigates the effect of market entry of new firms on incumbent firms' innovative activity measured as patent applications. The basic assumption is that the effect of entry varies by geographical distance between entrants and incumbents due to the presence of localized unobserved spillovers. In order to avoid endogeneity problems commonly associated with the timing of entry and entrants' location choice, I analyze entry induced by the establishment of university business incubators, which are usefully exogenous in time and space. The results show that entry has a statistically and economically significantly positive strategic effect on incumbent patenting.

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## **Session 4: Environmental Economics**

**Session Chair: Sayantan Ghosal, University of Warwick**

**Room: 32 MS 03**

**Date: March 29, 2010**

**Time: 13:30 - 15:00**

### **International Differences in Emissions Intensity and Emissions Content of Global Trade**

**Presented by: Shuichiro Nishioka, West Virginia University** (Stratford Douglas, West Virginia University)

Understanding international differences in the emissions intensity of trade and production is essential to understanding the effects of greenhouse gas limitation policies. We develop data on emissions from 48 industrial sectors in 32 countries and estimate the emissions intensity of production and trade. We find no evidence that developing countries specialize in emissions-intensive sectors; instead, emissions intensities differ systematically across countries because of differences in production techniques. Northern and Western European countries have the lowest emissions-intensity, while Southern and Eastern European countries and China have the highest emissions-intensity. Developed countries such as Japan and the United States whose trading partners are mostly developing countries import the most emissions.

### **Evaluating Emission Trading as a Policy Tool – Evidence from Conditional Jump Models**

**Presented by: Janina Ketterer, ifo Institut** (Marc Gronwald; ifo Institute)

This paper, first, empirically investigates European emission allowance (EUA) prices and, second, evaluates emission trading as a policy measure. Applying combined jump GARCH models yields strong evidence of conditional jump behavior. This implies that EUA prices are subject to unexpected movements and that a considerable degree of uncertainty is present. According to the real option literature, uncertainty has adverse effects on investment decisions. Thus, investments in abatement technologies are likely to be postponed due to the peculiar characteristics of emission allowance prices. Furthermore, this price behavior is at odds with the theoretical notion that emission prices equal marginal abatement costs.

### **Carbon leakage under incomplete environmental regulation: An industry-level approach**

**Presented by: Robert Ritz, Oxford University**

Carbon leakage is a major concern for policymakers involved with environmental initiatives such as the European Union's emissions trading scheme and similar cap-and-trade proposals in the United States, Australia and elsewhere. This paper provides a framework for understanding the drivers underlying carbon leakage at the level of an individual sector in which only a subset of firms is affected by such regulation. It provides simple formulae to estimate leakage rates using information on industry characteristics that is typically available to the analyst. Illustrative estimates for the steel industry in the EU ETS suggest carbon leakage of 25% or (much) higher -- unless environmental-efficiency improvements by regulated firms are substantial.

### **Unilateral Measures and Emissions Mitigation**

**Presented by: Sayantan Ghosal, University of Warwick** (Shurojit Chatterji, Singapore Management University; Sean Walsh, Center for International Governance Innovation; John Whalley, Center for International Governance Innovation and University of Western Ontario and NBER)

We discuss global climate mitigation that builds on existing unilateral measures to cut emissions. We document and discuss the rationale for such unilateral measures argue that such measures have the potential to generate positive spillover effects both within and across countries. In a simple dynamic model of learning we show that while single countries on their own may never get to the point of switching completely to low emission activities, a learning process with positive spillovers across nations will deliver a global switch to low emissions. We discuss the key features of a new global Intellectual Property (IP) regime that builds on the positive spillovers inherent in unilateral initiatives and accelerates global convergence to low emissions.

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## **Session 5: Development Economics**

**Session Chair: Nishith Prakash, Dartmouth College**

**Room: 33 MS 03**

**Date: March 29, 2010**

**Time: 13:30 - 15:00**

### **Inequality of educational opportunity in India: Changes over time and across states**

**Presented by: Mohammad Asadullah, University of Reading**

We document the extent of inequality of educational opportunity in India between 1983 and 2004. Building on recent developments in the literature operationalizing theoretical concepts of inequality of opportunity we construct two indices. Kerala stands out as the least opportunity unequal state in education. However significant inter-state divergence remains. Transition matrix analysis confirms substantial inter-temporal mobility in inequality of opportunity across India states. For instance, West Bengal and Orissa made progress in reducing inequality of opportunity. Among regions, Southern, North-eastern and Eastern regions on average experienced upward mobility in terms of decline in inequality of opportunity whilst Central region experienced downward mobility. We conclude examining the link between progress toward equality of opportunity, poverty reduction, economic growth and pro-poor policies.

### **The Blessing of Natural Resources: Evidence from a Peruvian Gold Mine**

**Presented by: Juan Rud, Royal Holloway, University of London** (Fernando Aragon; London School of Economics)

This paper studies the impact of Yanacocha, a large gold mine in Peru, on local population's welfare. Using annual household data for 1997-2006, we find robust evidence of a positive effect of the mine's demand of local inputs on real income. The effect, an average increase of 1.7% per 10% additional mine's purchases, is only present in the mine's supply market and surrounding areas. We also find improvements on welfare measures and poverty reduction. We examine and rule out that our results are driven by increased public expenditure associated to the mining revenue windfall. Using a spatial general equilibrium model, we interpret these results as evidence of net welfare gains generated by the mine's backward linkages and its multiplier effect.

### **Returns to English-Language Skills in India**

**Presented by: Nishith Prakash, Dartmouth College** (Aimee Chin, University of Houston & NBER and Mehtabul Azam, World Bank and IZA)

India's colonial legacy and linguistic diversity give English an important role in its economy, and this role has expanded due to globalization in recent decades. It is widely believed that there are sizable economic returns to English-language skills in India, but the extent of these returns is unknown due to lack of data containing measures of both earnings and English ability. In this paper, we use a newly available data set to quantify the effects of English-speaking ability. We find that being fluent in English increases hourly wages by 32%, which is as much as the return to completing secondary school and half as much as the return to completing a Bachelor's degree.

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## **Session 6: Auctions**

**Session Chair: Silvester van koten, CERGE-EI**

**Room: 72 MS 03**

**Date: March 29, 2010**

**Time: 13:30 - 15:00**

### **Efficient Auctions of An Indivisible Risky Asset to Buyers of Heterogeneous Risk Preferences**

**Presented by: Liang Zou, University of Amsterdam** (Audrey Hu; University of Amsterdam/Tinbergen Institute)

This paper concerns the efficient sale of an indivisible risky asset and the effects of changing risk in a setting where buyers exhibit heterogeneous risk preferences. The model allows asymmetric and interdependent values and types. Under certain conditions, efficient implementation in ex post equilibrium is possible through either a direct mechanism or an English auction, implying that the asset is allocated to the one who derives the highest expected utility surplus from the asset. As risk increases, the buyers are uniformly better off regardless of their risk attitudes (risk averse, neutral, or preferring). A fundamental reason for this "increasing risk effect" is the fact that the winner's utility surplus is a convex function of the utility of the pivotal bidder.

### **Charitable Asymmetric Bidders**

**Presented by: Olivier Bos, University of Cologne**

Recent papers show that all-pay auction is better at raising money for charity than first-price auction with symmetric bidders and under incomplete information. Yet, this result is lost with bidders enough asymmetric and under complete information. In this paper, we consider a framework on charity auctions with asymmetric bidders under some incomplete information. We determine all-pay auction still runs more money than first-price auction. Thus, all-pay auctions should be seriously considered when one wants to organize a charity auction.

### **Risk Aversion and Optimal Reserve Prices in First and Second-Price Auctions**

**Presented by: Audrey Hu, Tinbergen Institute/University of Amsterdam** (Steven A. Matthews; University of Pennsylvania and Liang Zou; University of Amsterdam)

We analyze the effects of buyer and seller risk aversion in first and second-price auctions. In both auctions the seller's optimal reserve price is shown to decrease in his own risk aversion - more so in the first-price auction. Thus, greater seller risk aversion increases the ex post efficiency of both auctions, and especially that of the first-price auction. The seller's optimal reserve price in the first-price, but not in the second-price, auction decreases in the buyers' risk aversion. Thus, greater buyer risk aversion also increases the ex post efficiency of the first but not the second-price auction. At the interim stage, the first-price auction is preferred by all buyer types in a lower interval, as well as by the seller.

### **Legal unbundling and auctions in vertically integrated (utility) markets**

**Presented by: Silvester van koten, CERGE-EI**

This paper addresses the effectiveness of auctions and legal unbundling as regulatory measures in an industry where a Vertically Integrated Producer (VIP) has a monopoly position in an essential upstream activity and also owns one of the firms active in the competitive downstream activity. In this configuration the VIP can – through increased aggressive bidding– increase its profit. I analyze the regulatory measure of legally separating the downstream firm from the VIP. I show that such a measure may only be partially effective; the VIP can formulate a compensation scheme that does not violate restrictions typically imposed by legal separation but induces the manager of the VIP-owned downstream firm to bid more aggressively, thereby increasing profits and decreasing efficiency.

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## **Session 7: Estimation of DSGE Models**

**Session Chair: Matthias Paustian, Bank of England**

**Room: 39 MS 02**

**Date: March 29, 2010**

**Time: 13:30 - 15:00**

### **DSGE Model Evaluation in a Bayesian Framework: an Assessment**

**Presented by: Alessia Paccagnini, Bocconi University**

This paper discusses the approximation problem of a Vector Autoregressive Moving Average (VARMA) representation of a Dynamic Stochastic General Equilibrium (DSGE) Model which has not all observed endogenous variables. In this article, a "Bayesian" Econometric technique, called the DSGE-VAR, is implemented to estimate a theoretical model, a DSGE model, by using a Vector Autoregressive (VAR) approximation. The empirical analysis is realized carrying out MonteCarlo experiments in the artificial world, using two different Data Generating Processes (DGP) a forward-looking and a backward-looking model. These experiments are followed by exercises in the real world.

### **Endogenous Persistence in an Estimated DSGE Model under Imperfect Information**

**Presented by: Paul Levine, University of Surrey** (Joseph Pearlman, London Metropolitan University; George Perendia, London Metropolitan University and Bo Yang; University of Surrey)

We provide a tool for estimating DSGE models by Bayesian Maximum-likelihood methods under very general information assumptions. This framework is applied to a New Keynesian model where we compare the standard approach that assumes an informational asymmetry between private agents and the econometrician, with an assumption of informational symmetry. For the former, private agents observe all state variables including shocks, whereas the econometrician uses only data for output, inflation and interest rates. For the latter both agents have the same imperfect information set and this corresponds to what we term the '*informational consistency principle*'. We first assume rational expectations and then generalize the model to allow some households and firms to form expectations adaptively. We find that in terms of model posterior probabilities, impulse responses, second moments and autocorrelations, the assumption of informational symmetry by rational agents significantly improves the model fit. We also find qualified empirical support for the heterogeneous expectations model.

### **Measurement with some theory: using sign restrictions to evaluate business cycle models**

**Presented by: Matthias Paustian, Bank of England** (Fabio Canova, UPF)

We propose a method to evaluate business cycle models which does not require knowledge of the DGP and is robust to the time series specification of the aggregate decision rules. We derive robust restrictions in a class of models; use some of them to identify structural shocks and others to evaluate the model. The approach has good size and excellent power properties even in small samples. The median of the distribution of the responses is a good estimator of the true responses. We examine the dynamics of hours in response to technology shocks and of consumption in response to government expenditure shocks.



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## **Session 8: Productivity: Theory and Measurement**

**Session Chair: Nicholas Oulton, London School of Economics**

**Room: 75 MS 02**

**Date: March 29, 2010**

**Time: 13:30 - 15:00**

### **Does Schumpeterian Creative Destruction Lead to Higher Productivity? The effects of firms' entry**

**Presented by: Carlos Carreira, Universidade de Coimbra** (Paulino Teixeira, Faculdade de Economia/GEMF, Universidade de Coimbra)

This paper discusses the impact of newly created firms on industry productivity growth. Our central hypothesis is that there are two potential effects of new firms on productivity growth: a direct effect, as entrants may be relatively more productive than the established firms; and an indirect effect through increased competitive pressure which stimulates established firms to elevate their in order to survive. The results of the decomposition exercise of aggregate productivity growth suggest that the direct contribution of entry is very limited, and smaller, than the exit effect. In turn, greater competition pressure generated by new entrants seems to have forced incumbent firms to improve their performance, leading to a higher level of aggregate productivity.

### **Workforce Training, Intangible Investments and Productivity in Europe: Evidence from EU KLEMS and the EU LFS**

**Presented by: Mary O'Mahony, University of Birmingham** (Fei Peng; University of Birmingham)

This paper employs industry data, derived from linking the EU LFS to productivity accounts from EU KLEMS, to examine workforce training and productivity. Training activities are first modelled as intangible investments and their contributions to aggregate growth are measured using a growth accounting method. Then econometric analysis is employed to evaluate links with ICT. The results suggest different impacts for production and service sectors. The analysis suggests that firm specific intangible investments may be more important in services than production industries. Training on its own seems important in production industries but the results do not support a clear link with ICT. In market services training appears to be beneficial only when interacted with ICT.

### **Do Foreign Mergers and Acquisitions Boost Firm Productivity?**

**Presented by: Iulia Siedschlag, The Economic and Social Research** (Marc Schiffbauer, The World Bank and Frances Ruane, The Economic and Social Research Institute, Dublin)

This paper examines the causal relationship between foreign mergers and acquisitions and firm productivity in the UK over the period 1999-2007. Our results raise questions about the existence of aggregate effects of foreign ownership on TFP in the longer-run. However, we find significant heterogeneity in the TFP effects of foreign M&A at the industry level. Overall, we uncover a systematic pattern of post-acquisition TFP effects that is consistent with the most recent theoretical models of firm heterogeneity and cross-border mergers and acquisitions as mode of foreign entry. Furthermore, we find positive aggregate effects on labor productivity due to capital deepening but not due to changes in TFP.

### **How to measure living standards and productivity**

**Presented by: Nicholas Oulton, London School of Economics**

I set out a general algorithm for calculating true cost-of-living indices when demand is not homothetic, ie when not all expenditure elasticities are equal to one, and when there are large numbers of products. The algorithm can be applied in both time series and cross section (eg to estimate PPPs). Superlative index numbers provide a practical method of estimating price indices, but are hard to interpret in the nonhomothetic case. The algorithm proposed here is equally practical for the nonhomothetic case, which is the important one empirically as Engel's Law demonstrates. The algorithm can also be used to estimate true producer price indices and consequently TFP in the presence of input-biased economies of scale.

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## **Session 9: Multinationals and Trade Agreements**

**Session Chair: Susanna Thede, Lund University Sweden**

**Room: 80 MS 02**

**Date: March 29, 2010**

**Time: 13:30 - 15:00**

### **Trade Agreements, Bargaining and Economic Growth**

**Presented by: Yishay Maoz, The Open University of Israel** (Dan Peled, University of Haifa and Assaf Sarid, University of Haifa)

Rebelo's two-sector endogenous growth model is embedded within a two-country international trade framework. The two countries bargain over a trade agreement that specifies: (i) the size of the foreign aid that the richer country gives to the poorer one; (ii) the terms of the international trade that takes place after the aid is given. The aid is given not because of generosity, but because it improves the capital allocation across the world and thus raises total world production. This world production surplus enables the rich country to raise its equilibrium consumption and welfare beyond their no-aid levels. To ensure it, the rich country uses a trade agreement to condition the aid on favorable terms of trade.

### **Sign, then Ratify: Negotiating under threshold constraints**

**Presented by: Sylvie Thoron, GREQAM**

The procedure for implementing any international treaty necessarily involves two steps. The negotiation phase which culminates in the signature of the treaty is followed by a ratification phase. This last phase is governed by a rule which determines how far the ratification process has to advance before the treaty can come into effect. The purpose of this paper is to analyse, using a game theoretical approach, the possible consequences of this minimum participation rule for the ratification phase and for the negotiation phase. I consider International Environmental Agreements in which, during the negotiation phase, the different parties have to decide on the level of a global target and on how to share the efforts necessary to reach it.

### **The Impact of China's Exports on Global Manufactures Prices**

**Presented by: Jing Zhang, University of Nottingham** (Xiaolan Fu, University of Oxford and Raphael Kaplinsky, Open University)

This paper analyses the impact of China's exports on the prices of exports from other countries using import data in the US, EU and Japan during 1989-2006. Findings suggest that China's exports have affected not just those countries whose competitiveness is largely based on low wages but all country groups in certain products sectors, destination markets and during different time periods. The middle income countries are the most affected by China's export expansion particularly post-1997 due to China's market expansion, WTO entry and exchange rate variation. The influence on high-income countries is only in low-technology sectors pre-1997. The impact on low-income countries is only significant in the medium- and high-tech sectors mostly pre-1997 and this effect weakened over time.

### **Exploring the Firm Boundary for Swedish Multinationals**

**Presented by: Susanna Thede, Lund University Sweden** (Markus Lindvert; Swedish Institute for Growth)

This paper empirically examines the foreign internalisation decision of multinational corporations. The purpose of the paper is to identify determinants of the firm boundary, where within-boundary production takes the form of foreign direct investments (FDI) and outside-boundary production takes place through international outsourcing, with reference to recently developed general-equilibrium trade theories incorporating firm behaviour. The empirical investigation is performed for 2246 multinationals production engagements in 148 foreign countries under the 1997 to 2006 period. The primary contribution of the paper is the investigation of firm behaviour per se instead of industry level implications of firm behaviour.

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## **Session 10: Globalization and FDI**

**Session Chair: Sarmistha Pal, Brunel University**

**Room 81 MS 02**

**Date: March 29, 2010**

**Time: 13:30 - 15:00**

### **Intellectual Property Rights, Foreign Direct Investment, and Industrial Development**

**Presented by: Kamal Saggi, SMU** (Lee Branstetter; Carnegie Mellon University)

This paper develops a North-South product model in which Southern imitation and the North-South flow of foreign direct investment (FDI) are endogenously determined. In the model, a strengthening of IPR protection in the South reduces the rate of imitation, which, in turn, increases the flow of FDI. The increase in FDI more than offsets the decline in production undertaken by Southern imitators, so that the South's share of goods produced by the global economy increases. Furthermore, real wages of Southern workers increase even though prices of goods produced by multinationals exceed those of Southern imitators. The preceding results hold when Northern innovation is endogenously determined; in addition, the rate of innovation increases with a strengthening of Southern IPR protection.

### **Do the Biggest Aisles Serve a Brighter Future? Global Retail Chains and Their Implications for Romania**

**Presented by: Beata Javorcik, University of Oxford** (Yue Li, The World Bank)

Many countries have opened their retail sector to foreign direct investment, yet little is known about implications of such liberalization for the economies of host countries. Using firm-level data from Romania, this study examines how the presence of global retail chains affects firms in the supplying industries. The results suggest that the expansion of global retail chains leads to a significant increase in the total factor productivity in the supplying industries. Their presence in a region increases the total factor productivity of firms in the supplying industries by 3.8 to 4.7 percent, while doubling the number of chains leads to an increase of 3.3 to 3.7 percent. The expansion of global retail chains benefits larger firms more than small enterprises.

### **Bridging the Gap? Corruption, Knowledge and Foreign Ownership**

**Presented by: Sarmistha Pal, Brunel University** (Nigel L. Driffield, Aston Business School; Tomasz Mickiewicz, UCL and Yama Temouri, Aston Business School)

There are large differences in institutional qualities in home and host countries around the world. While the existing literature highlights the adverse role of host country corruption on foreign investment, the present paper argues that an explanation of inter-country variation in foreign investment depends in addition on aspect of relative corruption, i.e., host corruption relative to home corruption. We use a large matched home-host firm-level panel data-set for 1997-2006 from selected European transition countries. Selectivity corrected estimates suggest that, ceteris paribus, higher absolute and relative corruption in host country lower foreign ownership while relative to other firms, knowledge-intensive parent firms need to protect their knowledge advantage and thus tend to have controlling ownership in host CEE countries.

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## **Session 11: Health, Human Capital and Labour Markets**

**Session Chair: Mohamed Marouani, Paris1-Panthéon-Sorbonne University**

**Room: 01 AC 01**

**Date: March 29, 2010**

**Time: 13:30 - 15:00**

### **The production function of cognitive skills: health, parental inputs and caste test gaps in India**

**Presented by: Florencia Lopez Boo, IDB and University of Oxford**

This paper explores the determinants of children's cognitive outcomes using novel panel data from India. Results show that lagged inputs matter in the production of current skills. When past inputs are not observed, past outcomes turn out to be a good proxy-indicator of this variable. Using an IV approach I find that 1 SD increase in HAZ at the age of one leads to cognitive test scores that are a quarter of 1 SD higher at age 5. I find that parents seem to 'reinforce' children for early favourable outcomes rather than 'compensate' them; and they do so more in lower caste families and particularly with boys.

### **The role of childhood health for the intergenerational transmission of human capital: Evidence from administrative data**

**Presented by: Martin Salm, Tilburg University (Daniel Schunk; University of Zurich)**

We use unique administrative data to examine the role of childhood health for the intergenerational transmission of human capital. Specifically, we estimate the extent to which a comprehensive list of health conditions – diagnosed by government physicians – accounts for developmental gaps between the children of college educated parents and those of less educated parents. In total, health conditions explain 18% to 29% of the gap in cognitive ability, based on estimations with different specifications of sibling fixed effects models. We conclude that family conditions are important in overcoming the negative effects of health conditions on child development. Furthermore, policies aimed at reducing disparities in child achievement and inequalities later in life should also focus on improving the health of disadvantaged children.

### **Does More Schooling Improve Health Behaviours and Health Outcomes? Evidence from U.K Twins**

**Presented by: Vikesh Amin, Royal Holloway, University of London (Jere R. Behrman; University of Pennsylvania)**

Schooling is associated with better health outcomes. Several studies have used changes in compulsory schooling laws in the United Kingdom as an exogenous variation in schooling, to estimate the causal effect of schooling on health outcomes have found mixed results. This paper adds to the evidence by adopting a twins methodology, using data from the Twins Research Unit at St Thomas' Hospital. We find (1) strong significant positive associations between schooling and health-related behaviours and outcomes but (2) generally no causal effects of schooling, suggesting that schooling may be proxying in part for unobserved endowments including family background and genetics that are both correlated with schooling and have direct causal effects on these behaviours and outcomes.

### **Assessing Interactions among Education, Social Insurance, and Labor**

**Presented by: Mohamed Marouani, Paris1-Panthéon-Sorbonne University (David Robalino; The World Bank)**

This paper develops a general equilibrium model to assess the impact of macroeconomic, education and social protection policies on employment. The model presents three innovations. First, it formalizes the production of skills. Second, it incorporates a module that projects social insurance expenditures as a function of the demographic structure of the country and the rules of the pension system. Finally, it develops a detailed description of the labour market. The results show that isolated interventions to improve the internal efficiency of the education system can aggravate the unemployment problem; that subsidies to investments are more efficient in sectors intensive in skilled labour; and that the growth of pension expenditures and the tax-wedge can depress employment in the formal sector.

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## **Session 12: Firm Heterogeneity: Trade and Investment Implications**

**Session Chair: Hitoshi Sato, Institute of Developing Economies**

**Room: AP 1**

**Date: March 30, 2010**

**Time: 9:00 - 10:30**

### **Outsourcing with Heterogeneous Firms**

**Presented by: Sasan Bakhtiari, University of New South Wales**

A dynamic model of outsourcing is introduced that incorporates heterogeneity among both upstream and downstream producers to explain the distribution of outsourcing firms observed in data. The environment is one of search frictions and incomplete contracts where final-good producers require a specialized input and, upon matching with a supplier, can only contract the quantity of input. The main predictions of this model are: 1) two integrated firms with the same productivity level might outsource or integrate, 2) high-productivity firms might outsource too, and 3) more productive producers match with more productive suppliers, whereas lower productivity producers match to lower productivity suppliers. Also 4) Firms might expand or shrink in size as a result of outsourcing.

### **Trade Flows, Multilateral Resistance and Firm Heterogeneity**

**Presented by: Alberto Behar, Oxford University** (Ben Nelson, Bank of England)

We present a gravity model that accounts for multilateral resistance, firm heterogeneity and country-selection into trade, while accommodating asymmetries in trade flows. A new equation for the proportion of exporting firms takes a gravity form: the extensive margin is also affected by multilateral resistance. If all countries reduce their trade frictions, the impact of multilateral resistance is so strong that bilateral trade falls in many cases. This is despite the larger trade elasticities implied by firm heterogeneity. For isolated bilateral changes in trade frictions, multilateral resistance effects are small for most countries, but are large when big importers are involved.

### **Business Process Outsourcing: The Home, the Host and the Service Provider**

**Presented by: Arti Grover, Delhi School of Economics**

The Business process outsourcing (BPO) industry has grown meteorically in the last decade. However, off shoring is still primarily analyzed through the lens of a home country. In this paper, we build a model to explain the stylized facts of the BPO industry by embedding the bargaining framework developed in Spencer and Qui (2001) in the Ruffin's (2001) quasi-specific factors general equilibrium model. Our model shows that a high ability BPO firm chooses to provide a simpler service if the skill distribution of the host country is biased in favor of low skill. Further, outsourcing to a larger host country may increase wage inequality in the home and that outsourcing synchronizes the wage inequality between the home and the host.

### **Firm Heterogeneity and FDI with Matching Frictions**

**Presented by: Hitoshi Sato, Institute of Developing Economies**

This paper examines the foreign direct investment (FDI) decisions of individual firms with a simple framework where heterogeneous firms and managers have to make matches for production. We find that predicted distributions of FDI firms are much more akin to real data than those suggested by the basic firm heterogeneity model, namely, there exists a range of firm productivities in which more productive firms may export while less productive firms may undertake FDI. Such a range of firm productivities becomes wider when either matching frictions increase or trade costs decline. Furthermore, matching frictions hurt production efficiency more for productive FDI firms than for less productive FDI firms.

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## **Session 13: Economics of Schooling**

**Session Chair: Giuseppe Migali, Lancaster University**

**Room: 03 MS 01**

**Date: March 30, 2010**

**Time: 9:00 - 10:30**

### **Money, Mentoring and Making Friends: The Impact of a Multidimensional Access Programme on Student Performance**

**Presented by: Orla Doyle, University College Dublin** (Kevin Denny, University College Dublin; Patricia O'Reilly, University College Dublin and Vincent O'Sullivan, University of Warwick)

This study evaluate a comprehensive university access programme that involves needs-based financial, academic and social support using a natural experiment which exploits the time variation in the expansion of the access programme across schools. The programme has parallels with US affirmative action programmes, although preferential treatment is based on socioeconomic status rather than ethnicity. Overall, we identify positive effects on the retention of students, first year exam results and overall degree classification, with the impact often stronger for higher ability students. We find similar patterns of results for the 'affirmative action' group i.e. the students that entering with lower grades. This study suggests that access programmes can be an effective means of improving academic outcomes for socio-economically disadvantaged students.

### **Academic performance, Educational Trajectories and the Persistence of Date of Birth Effects. Evidence from France**

**Presented by: Julien Grenet, Centre for Economic Performance, LSE**

This paper performs a precise quantification of date of birth effects throughout individuals' schooling and working life using high-quality French data. With respect to previous studies, our paper innovates by controlling explicitly for the confounding effects that may arise from the correlation between birth seasonality and socio-economic background. Our results indicate that although the test score gap between December and January-born pupils tends to narrow as they grow older, it remains significant until the end of secondary education. In the French context, we show that the combination of extensive use of grade retention and early school tracking is particularly harmful for the youngest pupils in their academic cohort and explains why date of birth effects persist into adulthood.

### **Are We Wasting Our Time at School? New and Recent Evidence on the Impact of Shortening the Length of Secondary Schooling**

**Presented by: Bettina Büttner, Otto-von-Guericke-University Magdeburg** (Stephan L. Thomsen; University of Magdeburg and ZEW Mannheim)

Based on a recent policy reform in the German state of Saxony-Anhalt, this paper evaluates the effects of reducing the length of secondary schooling on student achievement while holding the curriculum constant. In 2003 the 13th year of schooling was abolished for students studying in the 9th grade, while students from the 10th grade remained on a 13-year-track. The double cohort of graduates in 2007 is used as a natural experiment to identify the causal effects of shortening the length of secondary schooling. The results provide important insights into the interaction of school duration and learning intensity. We find significant negative effects on student performance in math, whereas the effects on that in literature and English are not statistically significant.

## **Funding, school specialisation and test scores: An evaluation of the specialist schools policy using matching models**

**Presented by: Giuseppe Migali, Lancaster University** (Steve Bradley, Lancaster University and Jim Taylor, Lancaster University)

We evaluate the effect on test scores of a major UK education reform which has increased funding of schools and encouraged their specialisation in particular subject areas, enhancing pupil choice and competition between schools. Using several data sets we apply matching methods to confront issues of the choice of an appropriate control group and selection bias. We demonstrate a statistically significant causal effect of the specialist schools policy on test score outcomes and test score gain. Average test scores increased by about 2-3 points but larger effects occur for more able pupils. The effect peaks after 4 years, at which point the additional funding ceases. A specialisation effect occurs yielding large improvements in test scores in particular subjects.

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## **Session 14: The Family, the Firm, and the Labour Market**

**Session Chair: Alex Bryson, National Institute of Economic and Social Research**

**Room: AP2**

**Date: March 30, 2010**

**Time: 9:00 - 10:30**

### **Meet the Parents? The Causal Effect of Family Size on the Geographic Distance between Adult Children and Older Parents**

**Presented by: Thomas Siedler, DIW Berlin and University of Essex** (Helena Holmlund, LSE and Stockholm University and Helmut Rainer, University of St Andrews)

An emerging question in demographic economics is whether there is a link between family size and the geographic distance between adult children and elderly parents. This study is the first attempt to estimate the causal effect of sibship size on the geographic distance between older parents and adult children by using a large administrative data set from Sweden. We find a positive association between sibship size and child-parent geographic distance. However, when we use multiple births and sibship sex composition as instruments for family size, we do not find any evidence that the relationship represents a causal effect.

### **Work or care: the labour market activity of grandparents in Australia**

**Presented by: Stephen Whelan, University of Sydney**

Care by grandparents represents a significant source of child care used by parents. Although governments are increasingly concerned about the labour market activity of older individuals, there is little research on how this type of caring impacts on the employment behaviour of working age grandparents. We use the Household, Income and Labour Dynamics in Australia dataset to examine the relationship between work and child caring by grandparents. We estimate models that identify the impact of caring on employment for both the intensive and extensive margin, taking account of potential endogeneity. The results indicate that a limited amount of caring by grandparents does not detract from employment. At high levels, however, caring reduces the time spent in paid employment.

### **Is Family-Ownership Detrimental to Workplaces? The impact of family-ownership on workplace closures and ownership change**

**Presented by: Alex Bryson, National Institute of Economic and Social Research** (Erling Barth, Institute of Social Research, Oslo and Harald Dale-Olsen, Institute of Social Research, Oslo)

Family-owned businesses differ from other businesses, not only in terms of size, but in owner preferences and managerial style. We explore the effects of family ownership on workplace survival and ownership change in Norway and Britain, two countries where the incidence of family firms and the conditions they face differ markedly. In Britain family ownership and family management are not significant determinants of closure or ownership change per se, but well performing family firms have a lower likelihood of closure than other firms. In Norway, on the other hand, performance does not differentially affect the probability of closure by family ownership status. Professionally-managed family businesses are less likely than non-family and family-managed family businesses to close.



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## **Session 15: Economic Growth: Empirics**

**Session Chair: Nina Czernich, ifo Institute for Economic Research**

**Room: 32 MS 03**

**Date: March 30, 2010**

**Time: 9:00 - 10:30**

### **Physical Investment and Economic Growth in the Chinese Provinces: Testing the Empirical Validity of the AK Model, 1952-2004**

**Presented by: Diego Romero-Avila, Pablo de Olavide University**

This paper tests the empirical validity of AK-type models for the Chinese provinces over the period 1952-2004. We aim to establish whether large permanent movements in the physical investment rate cause permanent movements in output growth rates. Towards this end, we analyze the deterministic and stochastic developments of the real per capita output growth and the total investment rate series, which do not reject the empirical validity of AK models. The estimation of autoregressive-distributed-lag-growth models provides evidence for the existence of a positive growth effect from physical investment in the long run, thus supporting the AK model. The same findings are found using a nonparametric frontier approach and are robust to the inclusion of other growth sources and transitional dynamics.

### **A Contribution to the Empirics of Welfare Growth**

**Presented by: Konstantinos Vrachimis, University of Cyprus** (Marios Zachariadis; University of Cyprus)

This paper compares the determinants of economic growth and welfare growth. Our main result is that determinants may differ or have different impact on welfare outcomes as compared to economic outcomes. Human capital plays a bigger role in determining the former, so that policies targeting human capital can have a greater effect on the welfare of societies than one would think by looking at their impact on economic growth. Institutions also have a greater effect on welfare growth compared to their impact on economic growth, consistent with the importance of government stability for the uninterrupted provision of health inputs. We conclude that there exist systematic differences for the impact of a number of factors on economic relative to welfare outcomes

### **Environmental Policy, Pollution and Economic Growth: Evidence from Panel Causality Tests**

**Presented by: Bruce Morley, University of Bath**

The aim of this study is to determine the causal relationship between two different measures of environmental policy and economic growth as well as the policy variables and pollution, using a panel of European countries from 1995 to 2006. The standard Granger non-causality approach is used, with panel cointegration and a dynamic panel approach for modelling the error correction model. The results suggest some evidence of long-run causality running from income growth to increased use of renewable energy and expenditure on the environment, although there is only evidence of short-run causality in the reverse direction. There is also evidence of long-run causality from pollution to environmental expenditure and vice versa.

### **Broadband Infrastructure and Economic Growth**

**Presented by: Nina Czernich, ifo Institute for Economic Research** (Oliver Falck, ifo Institute, CESifo; Max Planck, Institute of Economics; Tobias Kretschmer, Institute for Communication Economics and Ludger Woessmann; University of Munich, ifo Institute, CESifo and IZA)

We estimate the effect of broadband infrastructure, which enables high-speed internet, on economic growth in the panel of OECD countries in 1996-2007. Our instrumental-variable model derives its non-linear first stage from a logistic diffusion model where pre-existing voice-telephony and cable-TV networks predict maximum broadband penetration. We find that a 10 percentage-point increase in broadband penetration raises annual per-capita growth by 0.9-1.5 percentage points. Results are robust to country and year fixed effects and controlling for linear second-stage effects of our instruments. We verify that our instruments predict broadband penetration but not diffusion of contemporaneous technologies like mobile telephony and computers.

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## **Session 16: Wages and Employment**

**Session Chair: Nigar Hashimzade, University of Reading**

**Room: 33 MS 03**

**Date: March 30, 2010**

**Time: 9:00 - 10:30**

### **The Minimum Wage in a Deflationary Economy: The Japanese Experience, 1994-2003**

**Presented by: Ken Yamada, Singapore Management University** (Ryo Kambayashi, Hitotsubashi University and Daiji Kawaguchi, Hitotsubashi University)

The median wage in Japan has fallen nominally since 1999 due to a severe recession, while the statutory minimum wage has steadily increased over the same period. We used large micro-data sets from two government surveys to investigate how the minimum wage has affected wage distribution under the unusual circumstances of deflation. The compression of the lower tail of female wage distribution was largely explained by the increased real value of the minimum wage. The steady increases in the effective minimum wage reduced employment among low-skilled middle-aged female workers, but the mechanical effect associated with disemployment on wage compression was minimal. The minimum wage contributed to the reduction in the pay gap between full-time and part-time workers.

### **The employment effect of industry-specific, collectively-bargained minimum wages**

**Presented by: Hanna Kroeger, RWI Essen**

This paper estimates the employment effects of industry-specific, collectively-bargained minimum wages in Germany for three occupations associated with the construction sector using a difference-in-differences approach. I propose a truly exogenous control group in contrast to the control group design used in the literature. Additionally, an alternative indicator of the minimum wage bite is employed in addition to the Kaitz index, namely the proportion of workers earning exactly the minimum wage. I do not find a significantly negative employment effect, even though the minimum wage has been binding in (East) Germany. This result can be explained by models of monopsonic competition.

### **Reciprocity in Recessions**

**Presented by: Sebastian Strasser, University of Munich** (Martin G. Kocher, University of Munich)

We extend the well-known fair-wage effort hypothesis to situations in which firms are suffering from an economic downturn and test experimentally whether a "fair employment hypothesis" exists on markets where workers can build a reputation. The latter term suggests that firms could employ workers even if it is not profitable for them in the short run and refuse to use the threat of unemployment as a disciplining device in recessions. Our results show that, even though firms cut wages in times of economic distress if they are allowed, agents reduce effort levels only slightly. In contrast to the standard prediction of full unemployment for our setup, unemployment is almost non-existent in our data.

### **Growth and Inverted U in Child Labour: A Dual Economy Approach**

**Presented by: Nigar Hashimzade, University of Reading** (Uma Kambhampati; University of Reading)

While it is commonly accepted that the main cause of child labour is poverty, empirical observations suggest that economic growth is not always associated with the reduction in child labour. We show, in a dual economy framework, that the effect of productivity growth upon child labour may be positive or negative. In particular, changes in the productivity gap between the modern and the traditional sectors, due to the technological progress, can generate an increase in child labour. In a dynamic version of the model we also investigate how this effect depends on the quality of schooling. The predictions of the model are tested using the data from the Indian National Sample Survey.

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## **Session 17: Housing and Credit**

**Session Chair: Anthony Murphy, University of Oxford**

**Room: 72 MS 03**

**Date: March 30, 2010**

**Time: 9:00 - 10:30**

### **Did Easy Credit Lead to Economic Peril? Home Equity Borrowing and Household Behavior in the Early 2000s**

**Presented by: Daniel Cooper, Federal Reserve Bank of Boston**

Using data from the PSID, this paper examines how households' home equity extraction during 2001-to-2003 and 2003-to-2005 affected their spending and saving. The results show that a one-dollar increase in equity extraction led to roughly ninety-five cents higher consumption. Nearly all of this spending increase was reversed in the subsequent period. Much of these expenditures went toward home improvements. Equity extraction also led to some household balance sheet reshuffling. In particular, households who extracted equity were more likely than other households to pay down their higher-cost credit card debt and to invest in other real estate and businesses. Overall, the results in this paper are consistent with households' extracting equity to fund durable good purchases.

### **A Simple Model of Mortgage Write-Downs**

**Presented by: Christian Hott, Swiss National Bank**

The current crisis has demonstrated that many financial institutions have underestimated the risks associated with mortgages. The resulting losses have also heightened the general interest in the mortgage market. In this paper I develop a novel theoretical model of mortgage write-down rates that helps to understand their main underlying risk factors. Following the model, write-down rates are positively influenced by the house-price level, the loan to value of mortgages and interest rates. They are negatively influenced by the growth of house prices and the income level. The calibration of the model for the US, the UK, and Switzerland demonstrates that it is well able to describe the overall development of the actual write-down rates.

### **Subjective well-being and house prices**

**Presented by: Anita Ratcliffe, University of Bristol**

Bridging research in well-being, consumption and leisure, the premise of this paper is that well-being and house prices will be correlated if house prices are linked to consumption and leisure patterns. A causal link between consumption, leisure and house prices can arise through a wealth/credit mechanism, which benefits homeowners but hurts renters. Diverging consumption and leisure patterns could also fuel social comparisons that affect well-being over and above personal gains/losses. But if any association between consumption and house prices reflects third factors such as income shocks, a correlation between well-being and house prices emerges that is independent of tenure status. These hypotheses are tested empirically using the British Household Panel Survey. The evidence is consistent with a common factor channel.

### **House Prices and Credit Constraints: Making Sense of the U.S. Experience**

**Presented by: Anthony Murphy, University of Oxford** (John Duca; Federal Reserve Bank of Dallas and John Muellbauer; Nuffield College, Oxford)

Inverting the effective demand for housing implies that house prices depend on credit constraints (Meen (2001), Muellbauer and Murphy (1997) and Cameron, Muellbauer and Murphy (2006)), a theoretical result also demonstrated in Kim's (2007) home price-to-rent framework. Previous U.S. house price models lack data on credit constraints facing first-time home-buyers, likely accounting for the poor performance of house price models based on interest rates and income (Gallin, 2006). We incorporate such omitted data into house price models which yield stable long-run relationships, more precisely estimated income and interest rate coefficients, reasonable speeds of adjustment, and improved model fits. We use the models to examine various scenarios for future US house prices.

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## **Session 18: Education: Choice and Implications**

**Session Chair:** Ellen Greaves, **The Institute for Fiscal Studies**

**Room:** 39 MS 02

**Date:** March 30, 2010

**Time:** 9:00 - 10:30

### **Upgrading the Low Skilled: Is Public Provision of Formal Education a Sensible Policy?**

**Presented by:** Anders Stenberg, **Stockholm University**

Modern societies would potentially reap large benefits from upgrading low skilled but it is difficult to put in practice as employers are reluctant to train low skilled, and the low skilled are unwilling to participate. To circumvent these problems, a large supply of for-mal education in Sweden is complemented with that enrollees are eligible for financial support. This study uses data on Swedish siblings aged 24-43 in 1994 to estimate difference-in-difference-in-differences models 1990-2004. While the estimated average earnings return is 4.4 per cent, calculations indicate it is barely sufficient to cover the total costs.

### **Catch Me If You Can: Education and Catch-up in the Industrial Revolution**

**Presented by:** Erik Hornung, **ifo Institute for Economic Research** (Sascha O. Becker, University of Stirling and Ludger Woessmann, LMU Munich)

Existing evidence, mostly from British textile industries, rejects the importance of formal education for the Industrial Revolution. We provide new evidence from Prussia, a technological follower, where early-19th-century institutional reforms created the conditions to adopt the exogenously emerging new technologies. Our unique school-enrollment and factory-employment database links 334 counties from pre-industrial 1816 to two industrial phases in 1849 and 1882. Controlling extensively for pre-industrial development, we use pre-industrial education as an instrument to identify variation in later education that is exogenous to industrialization itself. We find that basic education significantly accelerated nontextile industrialization in both phases of the Industrial Revolution.

### **Globalization, redistribution, and the structure of public education**

**Presented by:** Thushyanthan Baskaran, **University of Heidelberg** (Zohal Hessami; University of Konstanz)

We analyze whether globalization affects the composition of public spending on education. We argue in the theoretical section that redistribution through transfers will become increasingly difficult with deepening global integration, causing governments to shift the composition of public education expenditures towards programs that increase the productivity, and thereby the market-income of low-ability individuals. One evident empirical implication of the theoretical model is therefore that with deepening globalization, governments will spend relatively more on primary than on tertiary education. We test this hypothesis with data on 110 countries over the 1999-2006 period.

### **What parents want: school preferences and school choice**

**Presented by:** Ellen Greaves, **The Institute for Fiscal Studies** (Simon Burgess, University of Bristol; Deborah Wilson, University of Bristol and Anna Vignoles, IOE)

We analyse what parents look for when choosing schools. We assemble a unique dataset combining survey information on parents' choices plus a rich set of socio-economic characteristics; administrative data on school characteristics, admissions criteria and spatial data to define the de facto set of schools available to each family in the survey. Our central analysis uses multinomial logistic regression to show that families value academic performance in schools. They also value school composition – preferring schools with low fractions of children from poor families. We compute trade-offs between these characteristics and are able to compare them for different families. Our results suggest that preferences do not vary greatly between different socio-economic groups once we fully account for constraints in parents' choice.

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## **Session 19: Fiscal Policy**

**Session Chair: Michal Horvath, University of Oxford**

**Room: 75 MS 02**

**Date: March 30, 2010**

**Time: 9:00 - 10:30**

### **Fiscal Shocks and The Real Exchange Rate**

**Presented by: Agustín Bénétrix, Trinity College Dublin** (Philip R. Lane IIS, Trinity College Dublin and CEPR)

We estimate the impact of shocks to government spending on the real exchange rate for a panel of member countries of the euro area. Our key finding is that the impact differs across different types of government spending, with shocks to public investment generating larger and more persistent real appreciation than shocks to government consumption. Within the latter category, we also show that the impact of shocks to the wage component of government consumption is larger than for shocks to the non-wage component. Finally, we highlight the different exchange rate responses between this group and a group of countries with floating exchange rates.

### **Fiscal Uncertainty and Currency Crises**

**Presented by: Inci Gumus, Sabanci University**

Fiscal deficits have been put forward as a standard factor in the occurrence of currency crises, and this view has been the subject of the first-generation models of currency crises. While most papers within this framework consider a fiscal deficit that occurs with certainty, in reality an increase in the fiscal burden of the government may be an uncertain outcome. This paper introduces a model where there is uncertainty about the occurrence of a fiscal deficit. In this setup, the fixed exchange rate regime becomes unsustainable even if the fiscal deficit does not materialize. Therefore, a speculative attack occurs and fixed exchange rate regime collapses with the mere possibility of a deficit, independently of whether this outcome materializes or not.

### **How to Deal with Increased Public Debt**

**Presented by: Michal Horvath, University of Oxford**

We compare optimal fiscal policy strategies under alternative perspectives on optimality with the aim to contribute to current policy discussions as well as to the historical debate on optimal tax dynamics. We show that a strategy of slow unwinding of increases in public debt and taxes following structural shocks is consistent with the unconditionally optimal policy in a New Keynesian framework with nominal rigidity and distortionary taxes. This contrasts with the emerging consensus derived in similar frameworks from welfare objectives defined over conditional expectations, recommending permanent level shifts in debt and taxes.

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## **Session 20: Rules and Optimal Monetary Policy**

**Session Chair: Engin Kara, University of Bristol**

**Room: 80 MS 02**

**Date: March 30, 2010**

**Time: 9:00 - 10:30**

### **Real-time Optimal Monetary Policy with Undistinguishable Model Parameters and Shock Processes Uncertainty**

**Presented by: Alessandro Flamini, University of Sheffield** (Costas Milas, Keele University and Rimini Centre for Economic Analysis)

This paper studies optimal real-time monetary policy when policymakers take the volatility of output gap and inflation as proxy of the undistinguishable uncertainty on the exogenous disturbances and the model parameters. The paper shows that when the volatility surrounding a specific state variable increases, the optimal policy response to that variable should increase too while the optimal response to the remaining state variables should attenuate or be unaffected. In this way policymakers move preemptively to reduce the risk of large deviations of the economy from the steady state that would deteriorate the distribution forecasts of the output-gap and inflation. When an empirical test is carried out on the US economy the model predictions tend to be consistent with the data.

### **Testing the Monetary Policy Rule in the US: A Reconsideration of the Fed's Behavior**

**Presented by: Zhirong Ou, Cardiff Business school** (Patrick Minford, Cardiff University and CEPR)

We calibrate a standard New Keynesian model with three alternative representations of monetary policy- an optimal timeless rule, a Taylor rule and another with interest rate smoothing- with the aim of testing which if any can match the data according to the method of indirect inference. We find that the only model version that fails to be strongly rejected is the optimal timeless rule. Furthermore this version can also account for the widespread finding of apparent 'Taylor rules' and 'interest rate smoothing' in the data, even though neither represents the true monetary policy.

### **Interest-Rate Policy and the Stability of Banking Systems**

**Presented by: Jan Wenzelburger, Keele University** (Hans Gersbach ETH Zurich)

We investigate a banking system subject to repeated macroeconomic productivity shocks. By lowering the interest rates, the central bank can increase the intermediation margin, which fosters the recapitalization of banks. We show that without lowering interest rates, the banking system faces the risk of collapsing. When interest policy is aimed only at avoiding a banking collapse, the economy converges with certainty to a consumption trap. In the consumption trap, the entire bank savings are needed to cover the banks' obligations and GDP is minimal. We present a positive analysis of conditions for interest-rate policies which resolve banking crises. Moreover, we provide an explanation of why banking crises such as the crisis in Japan may cause long-lasting economic downturns.

### **Micro-data on Nominal Rigidity, Inflation Persistence and Optimal Monetary Policy**

**Presented by: Engin Kara, University of Bristol**

The popular Calvo model with indexation (Christiano, Eichenbaum and Evans (2005)) and sticky information (Mankiw and Reis (2002)) model have guided much of the monetary policy discussion. The strength of these approaches is that they can explain the persistence of inflation. However, both of these theories are inconsistent with the micro data on prices. In this paper, I evaluate the consequences of implementing policies that are optimal from the perspective of models that overlook the micro-data by using a Generalized Taylor Economy (GTE) (Dixon and Kara (2007)). While there is no material difference between the GTE and its popular alternatives in terms of inflation persistence, a difference arises when it comes to the micro-data: the GTE is consistent with the micro-data.

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## **Session 21: Risk and Trust: Lab Evidence**

**Session Chair: Marisa Miraldo, Imperial College London**

**Room: 81 MS 02**

**Date: March 30, 2010**

**Time: 9:00 - 10:30**

### **Social Identity, Finance, and Competition: A Laboratory Experiment**

**Presented by: Stefan Bauernschuster, Ifo Institute for Economic Research** (Stefan Bauernschuster, Friedrich-Schiller-University Jena, Niels-Daniel Grosse, Friedrich-Schiller-University Jena and Oliver Falck; ifo Institute Munich)

This paper investigates how competition among suppliers of finance interacts with trust and trustworthiness in a laboratory one-shot trust game. To analyze these effects, we apply a 2x2 treatment design. We induce social identity by letting subjects play coordination games with clear focal points, leading to higher investments and trustworthiness in the trust game. Introducing competition of in-group and out-group investors leads to crowding out of social identity by reduced trustworthiness. We suggest that once competition comes into play, trustees perceive in-group trustors' investments as the outcomes of a competitive bidding process rather than voluntary trust, which crowds out reciprocity.

### **Preference for Skew in Lotteries: Evidence from the Laboratory**

**Presented by: Luis Santos-Pinto, University of Lausanne** (Thomas Astebro; Haute Ecole Commerciale Paris and Jose Mata; Universidade Nova de Lisboa)

Using a laboratory experiment we investigate how skew influences choices under risk. We find that subjects make significantly riskier choices when the distribution of payoffs is positively skewed, these choices being driven in part by the shape of the utility function but also by subjective distortion of probabilities. A utility model with probability distortion calibrated on laboratory data is able to explain why most gamblers in public lotteries buy only a small number of tickets.

### **Experimentally-validated survey evidence on individual risk attitudes in rural Thailand**

**Presented by: Bernd Hardeweg, Leibniz Universitaet Hannover** (Lukas Menkhoff; University of Hannover and Hermann Waibel, University of Hannover)

This study validates a survey-based measure of general risk attitude by an incentive compatible experiment. The research is conducted among more than 900 participants in rural Thailand and thus new for developing countries. Some results are different compared to results from advanced economies including a lesser understanding of the experiment, consumption level as best indicator of economic status, a smaller role of gender and "unexpected" signs of further variables. These differences can be largely explained by the different environment of a developing economy.

### **Are you what you eat? Experimental evidence on health habits and time and risk preferences**

**Presented by: Marisa Miraldo, Imperial College London** (Matteo M Galizzi; Queen Mary University of London)

With an experiment we assess whether time and risk preferences differ across individuals with different health habits. We invited 120 subjects to whom we administrate a session of experimental tests and questionnaires. The questionnaire covers health characteristics, habits and life style and behaviour in nutrition, drinking, smoking and physical exercise. A number of individual health and nutritional indexes is constructed (e.g. Healthy Eating Index). We then elicit risk and time preferences with paired lotteries and paired inter-temporal choices experimental tests. Conditional on observed health and life style variables, we estimate the shape of risk and time preferences for each subject, using Maximum Likelihood estimation. Results show evidence of risk aversion and present biased preferences and preferences differing with health habits.

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## **Session 22: Experimental Evidence on Firm Behaviour**

**Session Chair: Jeroen Hinloopen, University of Amsterdam**

**Room: 01 AC 01**

**Date: March 30, 2010**

**Time: 9:00 - 10:30**

### **An experimental test of the standard of proof in merger control**

**Presented by: Daniel Zizzo, University of East Anglia** (Bruce Lyons, University of East Anglia and Gordon Menzies, University of Technology Sydney)

There is considerable debate about the alternative economic approaches to merger control taken by competition authorities. However, differences in economic analysis are not the only reason for alternative decisions. We conduct an experiment in decision making in the context of merger appraisal, identifying the separate influences of different standards of proof, volumes of evidence, cost of error and professional training. The experiment was conducted on current practitioners from nine different jurisdictions, in addition to student subjects. We find that legal standards of proof significantly affect decisions, and identify specific differences due to professional judgment. We are further able to narrow the range of explanations for why professionalization matters.

### **Entry into Auctions: An Experimental Analysis**

**Presented by: Seda Ertac, Koc University** (Ali Hortacsu; University of Chicago and James Roberts; Duke University)

We investigate entry into first-price (FPA) and second-price auctions (SPA) using an experiment that elicits willingness-to-pay to enter (WTE). We find that subjects overpay to enter and also significantly overbid in both FPA and SPA. We then investigate whether introducing risk aversion (RA) or "joy of winning" (JOY) can explain the joint observation of over-entry and overbidding. Using bid data, we structurally estimate three models, one allowing RA, one allowing for JOY and one allowing for both. While a model with JOY alone overestimates WTE, RA alone can explain 38% but a model with both RA and JOY can explain 65% of WTE. Moreover, JOY appears to explain nearly all the male WTE but only 44% of the female WTE.

### **Going Once, Going Twice, Reported! Cartel Activity and the Effectiveness of Leniency Programs in Experimental Auctions**

**Presented by: Jeroen Hinloopen, University of Amsterdam** (Sander Onderstal, University of Amsterdam)

We experimentally examine the effectiveness of a leniency program against bidding rings in two commonly used auctions: the English auction (EN) and the first-price sealed-bid auction (FPSB). The leniency program does not affect the average winning bid, nor the average winning cartel bid. The program does deter cartel formation, but it makes cartels that do form more stable: subjects use the possibility to report the cartel as an additional stick to control cartel members. The results do not differ substantially across auction types although the deterrence effect of the leniency program is stronger in EN than in FPSB. At the same time we observe more defection from the cartel agreement in FPSB than in EN.



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## **Session 23: Behavioral Theories**

**Session Chair: Mirco Tonin, University of Southampton**

**Room: 02 AC 01**

**Date: March 30, 2010**

**Time: 9:00 - 10:30**

### **Once bitten, twice shy: on the causal effect of prior experiences on trusting behaviour**

**Presented by: Michael Naef; Royal Holloway, University of London** (Daniel Schunk; University of Zurich)

Theory suggests that positive and negative experiences are influential regarding the temporal dynamics of trusting behaviour. However, no empirical study has yet investigated such relations in detail. Here, based on repeated trust games over the period of one year, we are able to establish a strong causal link from past experience of untrustworthiness to reduced trusting behaviour. This causal link mainly functions by way of changed beliefs, and is moderated by social preferences. Experience of trustworthiness, in contrast, does not alter trusting behaviour. Furthermore, we show evidence that an increase in the experience of trust causes higher trustworthiness. We conclude that negative experiences in relation to trust might kick-start a vicious circle thus eroding overall levels of trust.

### **Social Comparisons and Reference Group Formation: Some Experimental Evidence**

**Presented by: Hugh Sibly, University of Tasmania** (Ian McDonald, University of Melbourne ; Nikos Nikiforakis, University of Melbourne and Nilss Olekalns, University of Melbourne)

We investigate reference group formation and the impact of social comparisons on ultimatum bargaining using a laboratory experiment. Three individuals compete in a real-effort task for the role of the proposer in a three-player ultimatum game. The role of the responder is randomly allocated. The third individual receives a fixed payment - our treatment variable - and makes no decision. The existence of a non-responder has a dramatic effect on bargaining outcomes. In the most extreme treatment, more than half of the offers are rejected. Behavior shows individuals exhibit self-serving bias in the way they define their reference groups.

### **Financial professionals' overconfidence: Is it experience, job, or attitude?**

**Presented by: Oliver Gloede, Leibniz University Hannover** (Lukas Menkhoff, Leibniz Universität Hannover)

This paper examines financial professionals' overconfidence in their forecasting performance. We are the first to compare individual financial professionals' self-ratings with their true forecasting performance. Data spans several years at monthly frequency. The forecasters in our sample do not provide feasible self-ratings compared to their true performance but show overconfidence on average. In analyzing this, we find an easing relation to experience. Job characteristics are also related to less overconfidence, such as being a fund manager and using fundamental analysis. The same effect is found for the attitude to herd, whereas recent forecasting success comes along with more overconfidence.

### **Disentangling the Sources of Pro-social Behavior in the Workplace: A Field Experiment**

**Presented by: Mirco Tonin, University of Southampton** (Michael Vlassopoulos; University of Southampton)

This paper presents evidence from a field experiment, which aims to identify the two sources of workers' pro-social motivation that have been considered in the literature: action-oriented altruism and output-oriented altruism. To this end we employ an experimental design that first measures the level of effort exerted by student workers on a data entry task in an environment that elicits purely selfish behaviour and we compare it to effort exerted in an environment that also induces action-oriented altruism. We then compare the latter to effort exerted in an environment where both types of altruistic preferences are elicited. We find that action-oriented altruism accounts for a significant increase in effort, while there is no additional impact due to output-oriented altruism.

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## **Session 24: Game Theory I**

**Session Chair: Javier Rivas, University of Leicester**

**Room: 03 MS 01**

**Date: March 30, 2010**

**Time: 16:30 - 18:00**

### **An Experiment on Correlation and Coordination in 2x2 games**

**Presented by: Indrajit Ray, University of Birmingham** (John Bone, University of York; Michalis Drouvelis, University of York)

We consider a parametric version of Chicken and Battle of the Sexes to test whether or not players correlate their strategies and thereby coordinate on pure Nash equilibria. We use two different correlation devices to send public signals and correlated messages in different sessions with different payoffs for these games and test whether the players follow the recommended strategies.

### **Non-cooperative convergence to the core in Nash demand games without random errors or convexity assumptions**

**Presented by: Jonathan Newton, University of Cambridge**

A learning dynamic is exhibited which ensures convergence to core allocations in a Nash demand game where the amount of good that can be produced by any set of players is given by a characteristic function. This is accomplished by the incorporation of joint strategic switching into the dynamic rather than, as in the previous literature, by assumptions of convexity of the characteristic function or a reliance on random errors. The stochastic stability properties of the model are then examined when random errors are added. Stochastically stable states are characterized and it is shown that, unlike previous analyses, a unique stochastically stable state can be obtained in the limit as the discretization of the strategy space becomes fine.

### **Repeated Interaction and the Revelation of Player's Type: A Principal-Monitor-Agent Problem**

**Presented by: Antonio Osorio-Costa, Universidad Carlos III Madrid**

This paper studies a dynamic principal-monitor-agent relation where a strategic principal delegates the task of monitoring the effort of the agent. Through repeated interaction the agent might learn the monitor type. We show that this process damages the principal's payoffs. We introduce the idea of replacement strategies, i.e. the principal replaces the monitor if she finds it optimal, disrupting the learning process. The associated replacement costs limit the efficiency of these strategies. Nonetheless these strategies provide a partial solution to the principal's problem. We also consider compensation incentives that are independent of the agent's informational state. Depending on the value of the replacement costs one strategic approach might be superior to the other.

### **Cooperation, Imitation and Correlated Matching**

**Presented by: Javier Rivas, University of Leicester**

We study a setting where imitative players are matched into pairs to play a Prisoners' Dilemma game. A well known result in such a setting is that under random matching cooperation vanishes for any initial interior condition. The novelty of this paper is that we add a certain correlation to the matching process: players that belong to a pair were both parties cooperate repeat partner next period whilst all other players are randomly matched into pairs. This intuitive correlation introduced in the matching process makes a significant amount of cooperation the unique outcome under mild conditions. Furthermore, we show that no separating equilibrium, i.e. a situation where cooperators and defectors are not matched together, exists.

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## **Session 25: International Macro**

**Session Chair: Megumi Kubota, University of York**

**Room: AP 1**

**Date: March 30, 2010**

**Time: 16:30 - 18:00**

### **Worthy Transfers? A Dynamic Analysis of Turkey's Accession to the European Union**

**Presented by: Luca Pensieroso, IRES - Université catholique de Louvain** (Gul Ertan Ozguzer; Izmir University of Economics and IRES, Université catholique de Louvain)

In this paper, we build a two-country dynamic general equilibrium model to study whether European citizens would benefit from the eventual accession of Turkey to the European Union. The results of the simulations show that Turkey's accession to the European Union is welfare enhancing for Europeans, provided that Turkish total factor productivity (TFP) increases sufficiently after enlargement. In the model with no capital mobility, the Europeans are better off if the Turkish TFP increase bridges more than 31% of the initial TFP gap between Turkey and the European Union. That figure becomes 45% when capital mobility is introduced.

### **Employment and exchange rates: the role of openness and technology**

**Presented by: Fernando Alexandre, Universidade do Minho** (Pedro Bação; University of Coimbra João Cerejeira; University of Minho Miguel Portela, University of Minho and IZA)

Economic theory suggests that the impact of exchange rates should vary with the degree of exposure to international competition and with the technology level. This paper contributes by bringing together these two views, both theoretically and empirically. We show that both the degree of openness and the technology level mediate the impact of exchange rate movements on labour market developments. According to our estimations, whereas employment in high-technology sectors seems to be relatively immune to changes in real exchange rates, these appear to have sizable and significant effects on highly open low-technology sectors. The analysis of job flows suggests that the impact of exchange rates on these sectors occurs through employment destruction.

### **Real Exchange Rates and Time-Varying Trade Costs**

**Presented by: Efthymios Pavlidis, Lancaster University** (Ivan Paya; Lancaster University and David A. Peel; Lancaster University)

Previous empirical work on the Purchasing Power Parity does not explicitly account for time-varying trade costs. Motivated by the recent gravity literature we incorporate a microfounded measure of trade costs into two nonlinear regression models for the real exchange rate. Using data for the dollar-sterling real exchange rate from 1830 to 2005, we provide significant evidence in favor of a positive relation between the level of trade costs and the degree of persistence of the real exchange rate.

### **Real Exchange Rate Misalignments: Theoretical Modeling and Empirical Evidence**

**Presented by: Megumi Kubota, University of York**

The real exchange rate (RER) misalignment is a key variable in academic and policy circles. Sustained RER overvaluations typically signal future exchange rate adjustments whereas currency undervaluation have actively been pursued to foster export-led growth. This paper builds an equilibrium RER model and one of the novelties is the derivation and solution of the intertemporal BOP equilibrium and equilibrium in traded/non-traded goods market based on the current account dynamics and Harrod-Balassa-Samuelson (HBS) productivities. Then, we estimate the fundamental RER equation using cointegration analysis for time series (Johansen, 1988; Wickens and Breusch, 1987) and panel data (Pesaran et al. 1999).

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## **Session 26: Macroeconomic Fluctuations and the Labour Market**

**Session Chair: Federico Di Pace, Birkbeck College**

**Room: AP 2**

**Date: March 30, 2010**

**Time: 16:30 - 18:00**

### **Real Wage Cyclicity: Understanding the Importance of Heterogeneity in Non-participation and Self-Employment Decisions**

**Presented by: Cyrus Farsian, University of Kent**

A recurring theme when estimating the cyclical behaviour of wages is the inability to control for composition bias and sample selection problems. Here, we take a different approach, by utilising econometric techniques and theoretical micro modelling we can relate aggregate measures of real wages with individual behaviour in the labour market. What we find, is that aggregate real wages become cyclically less responsive over the cycle. This is primarily because unlike previous studies we do not arbitrarily assign fixed weights to control for composition effects. Instead we make a direct and coherent connection between individual wage movements and aggregate wage statistics, enabling us to determine the direction and magnitude of biases in aggregate wage measures.

### **Wage Rigidities in an Estimated DSGE Model of the UK Labour Market**

**Presented by: Stephen Millard, Bank of England** (Renato Faccini, Bank of England and Stephen Millard, Bank of England and Francesco Zanetti, Bank of England)

This paper estimates a New Keynesian model with matching frictions and nominal wage rigidities on UK data. The estimation enables the identification of important structural parameters of the British economy, the recovery of the unobservable shocks that affected the UK economy since 1975 and the study of the transmission mechanism. Results show that with matching frictions wage rigidities have limited effect on inflation dynamics, despite improving the empirical performance of the model. The reason is the following. With matching frictions, marginal costs depend on unit labour costs and on an additional component related to search costs. Wage rigidities affect both components in opposite ways leaving marginal costs and inflation virtually unaffected.

### **Deep Habits and the Cyclical Behaviour of Equilibrium Unemployment and Vacancies**

**Presented by: Federico Di Pace, Birkbeck College** (Renato Faccini, Bank of England)

We extend the standard textbook search and matching model by introducing deep habits in consumption. The cyclical fluctuations of vacancies and unemployment in our model can replicate those observed in the US data, with labour market tightness being twenty times more volatile than consumption. Vacancies display a hump shaped response to technology shocks as well as autocorrelation coefficients that are in line with the empirical evidence. Our model preserves the cyclicity of the wages for the new hires and the calibration is consistent with the estimated elasticity of unemployment to unemployment benefits. The numerical simulations generate an artificial Beveridge curve which is in line with the data.

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## **Session 27: Econometrics: Forecasting and Structural Breaks**

**Session Chair: Simon Price, Bank of England**

**Room: 32 MS 03**

**Date: March 30, 2010**

**Time: 16:30 - 18:00**

### **Should macroeconomic forecasters use daily financial data and how?**

**Presented by: Andros Kourtellos, University of Cyprus** (Elena Andreou; University of Cyprus and Eric Ghysels; University of North Carolina)

There are hundreds of financial time series available on a daily basis that contain information about the future states of the economy. Can we efficiently use all this daily financial information for improving and/or updating macroeconomic forecasts? The literature has focused on how the use of a small set of financial series - usually aggregated at a monthly or quarterly frequency. Here, we introduce two methods for predicting inflation and real activity: (1) combinations of regressions that involve regressors with different sampling frequency, such as quarterly macro series and daily financial series and (2) a small set of daily financial factors extracted from the large cross-section of daily series along with quarterly frequency factors dominated by macroeconomic variables.

### **Macroeconomic Forecasting and Structural Change**

**Presented by: Domenico Giannone, Université Libre de Bruxelles** (Antonello D'Agostino; Central Bank and Financial Services Authority of Ireland and Luca Gambetti; Universitat Autònoma de Barcelona)

The aim of this paper is to assess whether explicitly modeling structural change increases the accuracy of macroeconomic forecasts. We produce real time out-of-sample forecasts for inflation, the unemployment rate and the interest rate using a Time-Varying Coefficients VAR with Stochastic Volatility (TV-VAR) for the US. The model generates accurate predictions for the three variables. In particular for inflation the TV-VAR outperforms, in terms of mean square forecast error, all the competing models: fixed coefficients VARs, Time-Varying ARs and the naïve random walk model. These results are also shown to hold over the most recent period in which it has been hard to forecast inflation.

### **(Un)Predictability and Macroeconomic Stability**

**Presented by: Antonello D'Agostino, Central Bank of Ireland** (Domenico Giannone; ECARES and CEPR and Paolo Surico; London Business School)

The ability of popular statistical methods, the Federal Reserve Greenbook and the Survey of Professional Forecasters to improve upon naïve forecasts of inflation and real activity has declined significantly in U.S. data moving from the pre-1985 to the post-1985 sample. The decline is larger for institutional forecasters and models based on large information sets. In the most recent period, there is evidence of predictability for inflation only one month ahead, and for unemployment rate and nonfarm payrolls at most horizons. Counterfactual analyses suggest that a change in the estimated coefficients has been relatively more important than a change in the estimated error variances to explain these findings.

### **Forecasting in the presence of recent and recurring structural change**

**Presented by: Simon Price, Bank of England** (Jana Eklund, Bank of England; George Kapetanios, Queen Mary College, London and Simon Price; Bank of England and City University)

We consider two approaches to forecasting in the presence of structural breaks: monitoring for change and then combining models that do/do not use pre-change data; methods robust to structural change (rolling regressions, forecast averaging over different windows and EWMA forecasting). We derive analytical results for the performance of robust methods relative to a full-sample benchmark. For a stochastic breaks model, MSFE of rolling regression < forecast averaging < full sample regression < EWMA. Results are also derived for models with deterministic breaks. We assess the methods with Monte Carlo experiments. Forecast averaging emerges as overall best. EWMA is very poor. We apply the tests to a number of UK and US macroeconomic series.

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## **Session 28: Asymmetric Information and Firm Behaviour**

**Session Chair: Abhinay Muthoo, University of Warwick**

**Room: 33 MS 03**

**Date: March 30, 2010**

**Time: 16:30 - 18:00**

### **Product Liability and the Virtues of Asymmetric Information**

**Presented by: Florian Baumann, University of Tübingen** (Tim Friehe; University of Konstanz)

This paper analyzes a two-period setup in which firms differ with respect to costs of care and may signal type via care-taking to consumers who cannot observe precaution taken ex ante, but do so ex post. We establish pooling and separating equilibria which will differ depending on the share of losses firms bear under strict liability. Most importantly, we show that (i) firms may choose higher care in a setting in which customers do not know the type of the firm than in a setting in which they do, and (ii) such deviations in precaution taken due to asymmetric information on firm type are predominantly welfare improving.

### **Imperfect Competition and Efficiency in Lemons Markets**

**Presented by: Abhinay Muthoo, University of Warwick** (Suresh Mutuswami, University of Leicester)

This paper studies the impact of competition on the degree of inefficiency in lemons markets. More precisely, we characterize the second-best mechanism (i.e., the optimal mechanism with private information) in a stylized lemons market with finite numbers of buyers and sellers. We then study the relationship between the degree of efficiency of the second-best mechanism and market competitiveness. The relationship between the first-best and second-best mechanisms is also explored.

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## **Session 29: Credit and Banking**

**Session Chair: Marianthi Anastasatou, University of Bristol**

**Room: 72 MS 03**

**Date: March 30, 2010**

**Time: 16:30 - 18:00**

### **Small and medium-sized enterprises, bank relationship strength, and the use of venture capital**

**Presented by: Klaus Schaeck, University of Wales (Bangor)** (Allen N. Berger, University of South Carolina, Wharton Financial Institutions Center, CentER, Tilburg University and Klaus Schaeck, University of Wales (Bangor))

We use data for SMEs in Italy, Germany, and the UK to focus on the bank-firm relationship and how this affects firms' use of venture capital. We test if firms substitute venture capital for multiple bank relationships to avoid rent-extraction by the main bank. Our findings are consistent with this hypothesis, and are robust to changes in estimation method and sample. Employing matching estimators, we conduct a 'horserace' to establish if performance differs between firms that use venture capital and those that rely on single or multiple bank relationships. The use of venture capital positively affects performance in terms of growth and R&D spending. However, such performance effects do not arise when firms rely on single or multiple bank relationships.

### **Regulatory intervention, market assessment, and bank liquidity creation during distress**

**Presented by: Thomas Kick, Deutsche Bundesbank** (Allen N. Berger, University of South Carolina; Christa H. S. Bouwman, MIT and Klaus Schaeck University of Wales (Bangor))

Liquidity creation is one of banks' *raison d'être*. But how does bank distress affect this ability to create liquidity? What happens to liquidity creation when a bank is identified as distressed by supervisory authorities and subject to regulatory intervention? To address these questions, we exploit a unique and proprietary dataset of German universal banks provided by the Deutsche Bundesbank for the period 1999-2008 with detailed information about measures taken against banks.

### **Inequality of Opportunity in the Credit Market**

**Presented by: Giuseppe Coco, City University/(Universita' di Bari)** (Giuseppe Pignataro; University of Bologna)

Under asymmetric information observable features of borrowers, such as wealth and collateral, play an important role in determining access to credit. We define equality of opportunity as the equal possibility of getting credit for a given aversion to effort. We establish that, due to larger cross subsidization, richer individuals are more likely to get credit for a given aversion to effort. Moreover Inequality of Opportunity is associated with an inefficient allocation of resources as marginal richer borrowers exert less effort in equilibrium than poorer ones. This suggests that public credit policies should be targeted at poorer classes of borrowers both for equity and efficiency reasons.

### **Financial development, openness and competition in the Euro Area and the US**

**Presented by: Marianthi Anastasatou, University of Bristol** (Rebekka Christopoulou, Cornell University and Philip Vermeulen, ECB)

This paper suggests that financial development leads to lower markups in the Eurozone and US over the period 1981-2004. Financial depth has a greater effect on competition in sectors where firms are unusually dependent on external finance. This relation is stronger over the period 1995-2004. However, these results are not robust to the use of different measures for financial development or external dependence. Furthermore, there is evidence that the trade openness of countries is linked with higher competition and thus lower markups. This finding appears to be stronger for industries traditionally defined as tradable. Controlling for the two variables simultaneously we find that trade openness has greater explanatory power for the extent of competition compared to financial depth.

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## **Session 30: Wages and Inequality**

**Session Chair: Karen Mumford, University of York**

**Room: 39 MS 02**

**Date: March 30, 2010**

**Time: 16:30 - 18:00**

### **Polarization and Rising Wage Inequality - Comparing the US and Germany**

**Presented by: Dirk Antonczyk, University of Freiburg** (Thomas DeLeire; University of Wisconsin - Madison and Bernd Fitzenberger; University of Freiburg)

In this paper, we estimate trends in wage inequality in the US and in Germany. The methods employed enable us to separately identify lifecycle wage profiles, macroeconomic shifts, and cohort effects. Because we observe different macro-trends in wage inequality in the US and in Germany, it is unlikely that SBTC stories can account for polarization in wages and employment in the US. Under this story, we would expect to see similar impacts of SBTC in Germany. A more likely possibility is that episodic changes resulting from changes in institutional factors are responsible or that SBTC interacts in important ways with institutional factors. Differences in institutions across economies may be the reason why we observe different trends in inequality across countries.

### **Reservation Wages, Expected Wages and the Duration of Unemployment: Evidence from British Panel Data.**

**Presented by: Karl Taylor, University of Sheffield** (Sarah Brown; University of Sheffield)

We analyse the role of wage expectations in an empirical model of incomplete spells of unemployment and reservation wages. To be specific, we model the duration of unemployment, reservation wages and expected wages simultaneously for a sample of individuals who are not in work, where wage expectations are identified via an exogenous policy shock based upon the introduction of Working Family Tax Credits (WFTC) in the UK. The results from the empirical analysis, which is based on the British Household Panel Survey, suggest that WFTC eligibility served to increase expected wages and that expected wages are positively associated with reservation wages. In addition, incorporating wage expectations into the econometric framework was found to influence the magnitude of the key elasticities.

### **Greater Wage Inequality Reduces Average Hours of Work**

**Presented by: Urban Sila, London School of Economics / Bank of Slovenia**

In this paper I argue that rising inequality in offered wages lowers average working hours in the economy. If the labour supply is concave in wages, a decrease in working hours of low-paid workers is greater than an increase in working hours of high-paid workers. Furthermore, due to low market opportunities, some low-paid workers may leave the labour force and become inactive. Using the CPS-MORG data for prime-age men for the period 1979-2008 I find evidence in support of this explanation. I establish empirically the concavity of the labour supply and I find evidence that after controlling for the average wage, wage inequality has a negative and significant effect on the labour supply. This result is robust to various specifications.

### **Gender Gaps Across the Earnings Distribution in Britain: Are Women Bossy Enough?**

**Presented by: Karen Mumford, University of York, IZA** (Yekaterina Chzhen; University of York)

This paper investigates gender differences between the log wage distributions of full-time British employees in the public and private sectors. After allowing for positive selection into full-time employment by women, we find significant and substantial gender earnings gaps, and evidence of glass ceilings, in both sectors. The earnings gaps amongst the higher income earners are found to be related to there being a scarcity of senior women in high skilled, white-collar occupations, especially in the public sector.



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## **Session 31: Aspects of Migration**

**Session Chair: Rukhsana Kausar, University of Surrey**

**Room: 75 MS 02**

**Date: March 30, 2010**

**Time: 16:30 - 18:00**

### **Return and onward migration of highly educated: evidence from residence spells of Finnish graduates**

**Presented by: Mika Haapanen, University of Jyväskylä & University of Cambridge** (Hannu Tervo; University of Jyväskylä)

In this paper we examine inter-regional migration behaviour of young adults graduating from the Finnish universities in 1991–2003. We distinguish those who study in their home region from the others. For the latter graduates, we analyse both onward and return migration. Discrete-time models of residence duration are specified that allow us to study how the propensities to move change over the course of the residence spell. Our findings indicate that two-year before and during the graduation year the hazard rates of migration are increasing, and decreasing thereafter. This result is found not only for those who study at their home region but as well for those who are studying away and are contemplating return and onward migration.

### **Distortionary Taxation, Debt, and Immigration**

**Presented by: Michael Ben-Gad, City University**

We investigate the behavior of a dynamic overlapping dynasties growth model with factor taxation to determine how much the natives of a country absorbing a flow of immigrants can use shifts in factor taxation or deficit finance to redistribute immigrant income to themselves. Our results suggest that because of the steep dead weight loss incurred when factor taxes deviate from equality the scope for redistribution through intratemporal shifts from capital to labor is very small---the optimal tax on capital drops by approximately a percentage point for each percent inflow of immigrants. Much greater benefits are achieved by shifting taxes across time.

### **The Role of Network Autocorrelation in Modelling German Internal Migration: A Spatial Dynamic Panel Data Approach**

**Presented by: Timo Mitze, RWI Essen**

This paper analysis the role of network dependency structures in a dynamic panel data (DPD) model for German internal migration since re-unification. The standard neoclassical migration model serves as theoretical basis. We start from its aspatial specification and show by means of residual testing that network autocorrelation effects are highly present. Then, building upon recent empirical work on specifying spatial weighting structures in closed systems of interregional flow data we construct a set of spatial weighting schemes and apply both spatial filtering and spatial regression techniques to control for underlying network autocorrelation. We observe that after controlling for spatial dependency a greater role is assigned to regional real wage rate differences relative to unemployment rate signals in directing migration flows.

### **Who Performs Better? Earnings Differences Between Refugees/Asylum Seekers and Economic Immigrants**

**Presented by: Rukhsana Kausar, University of Surrey** (Stephen Drinkwater; University of Wales (Swansea))

The UK has long been considered a safe haven for immigrants, especially for refugees and asylum seekers. This paper adds to the literature by distinguishing between the labour market performance of asylum seekers/refugees and economic immigrants using Labour Force Survey (LFS) data for 2001-2006. Immigrants are classified into four categories using information from various sources and matching this to the LFS. Earnings differentials are then examined using regression techniques and reveal significant differences between the immigrant groups, with refugees/asylum seekers faring worst. In contrast, both categories of economic migrants perform substantially better. It is also found that labour market outcomes are greatly influenced by particular factors, especially education, location, ethnicity and years since migration, and these vary by immigrant group.

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## **Session 32: Marriage and Economics of the Household**

**Session Chair: John Knowles, University of Southampton**

**Room: 80 MS 02**

**Date: March 30, 2010**

**Time: 16:30 - 18:00**

### **Divorce property division laws and the decision to marry or cohabit**

**Presented by: Hayley Fisher, University of Cambridge**

I present a model of the choice between marriage and cohabitation for a couple who are forming a relationship. The model is used to analyse the implications of changing from title based division of property on divorce to equal sharing. Conforming to popular expectations, the change to equal sharing prevents some wealthy individuals from marrying due to the risk to their contributions if divorce occurs. Offsetting this, the equal sharing regime enables cooperative investments to be made in marriage, increasing its value relative to cohabitation. Overall the impact on the marriage rate is ambiguous, although it is most likely to increase where unilateral divorce laws make cooperative investments more difficult, and where couples are more similar to each other.

### **Marriage, Fertility and Step-Families: An Equilibrium Analysis**

**Presented by: John Knowles, University of Southampton** (John Kennes, University of Aarhus)

We develop a simple competitive equilibrium model of the marriage market with single mothers and step-families. We then explore the role of trends in relative wages and other observed changes, such as divorce rates, cohabitation and contraception technology, in accounting for the evolution of the distribution of family types since 1945.

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## **Session 33: Public Economics I**

**Session Chair: Esteban Jaimovich, Collegio Carlo Alberto**

**Room: 81 MS 02**

**Date: March 30, 2010**

**Time: 16:30 - 18:00**

### **Creative Destruction and Fiscal Federalism: A Study of Three Regions**

**Presented by: Jan Schnellenbach, University of Heidelberg** (Jan Schnellenbach, University of Heidelberg; Thushyanthan Baskaran, University of Heidelberg and Lars P. Feld, University of Heidelberg)

We analyze the rise and decline of the steel and mining industries in Saarland, Lorraine und Luxemburg over a period from the mid-19th century to 2003. Differences in the institutional framework of these regions are exploited to analyze how the broader fiscal constitution sets incentives for governments to either obstruct or to encourage structural change in the private sector. Fiscal autonomy of a region subjected to structural change in its private sector is associated with a relatively faster decline of employment in the sectors affected. Transfers are not used to speed up the destruction of old sectors, but rather to stabilize incomes.

### **Endogenous Move Structure and Voluntary Provision of Public Goods: Theory and Experiment**

**Presented by: Daniele Nosenzo, University of Nottingham** (Martin Sefton ; University of Nottingham)

We examine voluntary contributions to a public good (Varian, 1994) when the timing of contributions is endogenously determined by contributors. We show that the move order that is predicted to emerge is sensitive to how commitment opportunities are modeled: a favorable move order is predicted to emerge in Hamilton and Slutsky's (1990) 'observable delay' extended game, but a detrimental move order is predicted in their 'action commitment' game. In a laboratory experiment designed to examine these predictions we find that the detrimental move order is seldom observed in both games. Instead of committing to low contributions, players tend to avoid making a commitment. Our results suggest that commitment opportunities may be less damaging to public good provision than previously thought.

### **Budgetary Separation of Powers in the American States and the Tax Level: A Theoretical Analysis**

**Presented by: Leandro de Magalhaes, Bristol University** (Lucas Ferrero, Bocconi University)

In this paper we look at the role the degree of alignment between the Governor and the Legislature has on the state's tax level. We measure this alignment with the percentage of seats the Governor's party has in the state Legislature. We estimate semi parametrically a non-linear relationship between these two variables. We propose a model that rationalizes this non-linear relationship. The main driving force of the model is that the tax level in the American states depends on the size of the overlap between the Governor's constituency and the Legislature's constituency. Any attempt by the Legislature to target spending to the part of her constituency not covered by the Governor would be vetoed.

### **Excessive Public Employment and Rent-Seeking Traps**

**Presented by: Esteban Jaimovich, Collegio Carlo Alberto** (Juan Pablo Rud; Royal Holloway)

We propose an occupational choice model in which the quality of the bureaucracy determines output and entrepreneurship through its participation in the labour market. Agents differ in their public service motivation. A "good" equilibrium arises when motivated agents self-select into bureaucracy. There, bureaucrats employ few workers, which disciplines wages and keeps profits high, attracting self-interested agents into entrepreneurship. However, if self-interested agents become bureaucrats, they abuse their position to extract rents by employing an excessive number of workers. This generates an upwards pressure on wages, which lowers profits and deters entrepreneurship. The model also shows that a rent-seeking bureaucracy may gain political support from the working class. We provide evidence supporting the mechanism in our model.

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## **Session 34: Economic Theory I**

**Session Chair: Gregory Ponthiere, Paris School of Economics**

**Room: 01 AC 01**

**Date: March 30, 2010**

**Time: 16:30 - 18:00**

### **Complete Sequential Equilibrium and Its Alternative**

**Presented by: Hanjoon Jung, Lahore University of Management Sciences**

We propose a complete version of the sequential equilibrium (CSE) and its alternative solution concept (WCSE) for general finite-period games with observed actions. The sequential equilibrium (SE) is not a complete solution concept in that it might not be a Nash equilibrium in the general games that allow a continuum of types and strategies. The CSE is always a Nash equilibrium in the general games and is equivalent to the SE in finite games. So, the CSE is a complete solution concept in the general games as a version of the SE. The WCSE is a weak, but simple version of the CSE. It is also a complete solution concept and functions as an alternative solution concept to the CSE.

### **Admissibility and Event-Rationality**

**Presented by: Spyros Galanis, University of Southampton** (Paulo Barelli; University of Rochester and Spyros Galanis; University of Southampton)

Brandenburger et al. (2008) establish epistemic foundations for admissibility in games using lexicographic type structures. However, their construction is empty in complete and continuous type structures, suggesting that players need prior knowledge before playing admissible strategies. Using standard type structures and the notion of event-rationality we argue that prior knowledge is not required for Iterated Admissibility (IA). Common belief in event-rationality is characterized and, in a complete structure, generates the admissible strategies that survive the iterated elimination of strongly dominated strategies. Extending event-rationality generates the IA strategies in a complete structure. Contrary to the negative result in Brandenburger et al. (2008), we show that our constructions are nonempty in complete, continuous and compact type structures, therefore providing an epistemic criterion for IA.

### **When queueing is better than push and shove**

**Presented by: Paul Schweinzer, University of Manchester** (Alex Gershkov, Hebrew University of Jerusalem and Paul Schweinzer, University of Manchester)

We address the scheduling problem of reordering an existing queue into its efficient order through trade. To that end, we consider individually rational and balanced budget direct and indirect mechanisms. We show that this class of mechanisms allows us to form efficient queues provided that existing property rights for the service are small enough to enable trade between the agents. In particular, we show on the one hand that no queue under a fully deterministic service schedule such as first-come, first-serve can be dissolved efficiently and meet our requirements. If, on the other hand, the alternative is full service anarchy then every existing queue can be transformed into its efficient order.

### **Existence and Stability of Overconsumption Equilibria**

**Presented by: Gregory Ponthiere, Paris School of Economics**

Growth models with endogenous mortality assume generally that life expectancy is increasing with output per capita, and, thus, with individual consumption, whatever the consumption level is. However, empirical evidence on the effect of overconsumption and obesity on mortality tends to question that postulate. This paper develops a two-period OLG model where life expectancy is a non-monotonic function of consumption. The existence, uniqueness and stability of steady-state equilibria are studied. It is shown that overconsumption equilibria - i.e. equilibria at which consumption exceeds the level maximizing life expectancy - exist in highly productive economies with a low impatience. Stability analysis highlights conditions under which there exist non-converging cycles in output and longevity around overconsumption equilibria.

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## **Session 35: Aspect of Financial Crisis**

**Session Chair: Peter Spencer, University of York**

**Room: 02 AC 01**

**Date: March 30, 2010**

**Time: 16:30 - 18:00**

### **Recovery determinants of distressed banks: Regulators, market discipline, or the environment?**

**Presented by: Michael Koetter, University of Groningen** (Thomas Kick, Deutsche Bundesbank and Tigran Poghosyan, International Monetary Fund)

Based on detailed regulatory intervention data among German banks during 1994-2008, we test if supervisory measures affect the likelihood and the timing of bank recovery. Severe regulatory measures increase both the likelihood of recovery and its duration while weak measures are insignificant. This finding holds also for the restricted sample of relatively well performing banks, suggesting that there is no evidence of "bad" bank selection. More transparent publication requirements of public incorporation are barely significant. Increasing earnings and cleaning credit portfolios are consistently of importance to increase recovery likelihood, whereas earnings growth accelerates the timing of recovery. Macroeconomic conditions also matter for bank recovery. Hence, concerted micro- and macro-prudential policies are key to facilitate distressed bank recovery.

### **Price discovery on traded inflation expectations: Does the financial crisis matter?**

**Presented by: Jelena Stapf, Deutsche Bundesbank** (Alexander Schulz, Deutsche Bundesbank)

We analyze contributions of different markets to price discovery on traded inflation expectations and how it changed during the current financial crisis. We use a new high frequency data set on inflation-indexed and nominal government bonds as well as inflation swaps to calculate information shares of break-even inflation rates in the euro area and the US. The bond market dominates the price discovery process in both currencies particularly for longer maturities. The severe financial crisis drove a wedge between bond and swap break-even inflation rates and the derivative market lost further ground. Against the backdrop of the most severe financial crisis in decades contributions to price formation concentrated a lot more on the presumably safest financial instrument: government bonds.

### **Asymmetric information and the behavior of the inter-bank wholesale deposit market in a financial crisis**

**Presented by: Peter Spencer, University of York**

The inter-bank deposit market normally offers liquidity on low margins based on mutual monitoring and trust, with central bank funding usually acting as a backstop for liquidity. However, during a financial crisis a problem of default risk arises because these deposits are neither secured nor formally guaranteed by government. Asymmetric information is critical in this respect, since it is hard for outsiders to value bank assets, particularly when these are not marketable. The model developed in this paper is based on the deferred filtration approach of Duffie and Lando (2001) which gives creditors a lagged value signal. It suggests that these markets are fragile and prone to break down.

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## **Session 36: Investment and Financing Constraints**

**Session Chair: Oleksandr Talavera, University of East Anglia**

**Room: 03 MS 01**

**Date: March 30, 2010**

**Time: 18:05 - 19:35**

### **Investment, irreversibility, and financing constraints: evidence from a panel of transition economies**

**Presented by: Serafeim Tsoukas, University of Nottingham** (Alessandra Guariglia, University of Durham and John Tsoukalas, University of Nottingham)

Using a panel of 4223 Bulgarian, Czech, Polish, and Romanian firms, over the period 1998-2005, we show that those firms more likely to face irreversibility constraints exhibit lower sensitivities of investment to cash flow, and higher sensitivities of cash accumulation to cash flow. This suggests that in the presence of a rise in their cash flow, these firms will not accumulate fixed assets that they may find difficult to liquidate in hard times, but will prefer to accumulate cash for precautionary reasons. The presence of irreversibility constraints provides therefore a new explanation for why some financially constrained firms may exhibit low investment-cash flow sensitivities.

### **Corporate Finance and Comparative Advantage**

**Presented by: Peter Egger, ETH Zurich** (Christian Keuschnigg, University of St. Gallen, IFF-HSG)

Innovative firms typically have a high growth potential, need external funds to finance investment, and rely on the key effort and know-how of inside entrepreneurs. Given the limited amount of tangible assets and the non-contractible nature of entrepreneurial effort, these firms are often financially constrained. Access to external funds becomes an important factor in the expansion of innovative industries. This paper models a two sector economy of innovative and standard industries and shows how the pattern of comparative advantage is shaped by factor endowments and variables relating to corporate finance. In particular, a larger equity ratio of young entrepreneurial firms and tough corporate governance standards relax the financing constraints and create a comparative advantage in innovative industries.

### **Does the investment opportunities bias affect the investment-cash flow sensitivities of unlisted SMEs?**

**Presented by: Alessandra Guariglia, Durham University** (Bert D'Espallier; Lessius Hogeschool)

Using a panel of 5,999 small and medium-sized Belgian enterprises (SMEs) over the period 2000-2004, we identify three measures of investment opportunities suitable for unlisted firms. We then estimate firm-varying investment-cash flow sensitivities (ICFS) from reduced-form investment equations that include these measures, and compare them with those derived from a model that does not control for investment opportunities. We find that all our models yield similar ICFS estimates, which are significantly related to a wide set of proxies for financing constraints. These findings suggest that the ICFS of SMEs do not simply reflect investment opportunities. The investment opportunities bias may therefore have been overstated in previous literature.

### **Corporate Liquidity Management and Future Investment Expenditures**

**Presented by: Oleksandr Talavera, University of East Anglia** (Christopher Baum; Boston College and Mustafa Caglayan; University of Sheffield)

This paper empirically examines whether additional future fixed capital and R&D investment expenditures induce firms to accumulate cash reserves while considering the role of market imperfections. Implementing a dynamic framework on a panel of US, UK and German companies, we find that firms make larger additions to cash holdings when they plan additional future R&D rather than fixed capital investment expenditures. This behavior is particularly prevalent among small and non-dividend paying firms that are heavily involved in R&D activities. We also show that the cash flow sensitivity of cash is substantially higher for financially constrained firms than for their unconstrained counterparts in the US and the UK, but only marginally higher in Germany.

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## **Session 37: Social Groups, Status and Giving**

**Session Chair: Alan Kirman, EHESS, Université Paul Cézanne**

**Room: AP 1**

**Date: March 30, 2010**

**Time: 18:05 - 19:35**

### **On Status Concerns and Optimal Fundraising**

**Presented by: Parimal Bag, National University of Singapore** (Murali Agastya; University of Sydney and Santanu Roy; Southern Methodist University)

Concern for achieving higher social status by potential donors has been used as a possible explanation for charities, churches, arts and museums, universities, etc. announcing donations. Glazer and Konrad (1996, AER) formalized this idea by assuming the institutions report the donations precisely. We question the optimality of 'precise reporting'. It is shown that a broadly defined 'category reporting' would dominate precise reporting in terms of overall expected donations generated, when donors want to signal their wealth.

### **Modelling Charitable Donations to an Unexpected Natural Disaster: Evidence from the U.S. Panel Study of Income Dynamics**

**Presented by: Sarah Brown, University of Sheffield** (Mark N. Harris; Monash University and Karl Taylor; University of Sheffield)

Using household-level data, we explore the relationship between donations to the victims of the 2004 Indian Ocean tsunami disaster and other charitable donations. The evidence suggests that donations for the victims of the tsunami are positively associated with the amount previously donated to other charitable causes. This relationship exists when we decompose overall charitable donations into different types of philanthropy, with charitable contributions to caring, needy and religious organizations having the largest positive association with donations to the victims of the tsunami. When we explore the impact of donations to the victims of the tsunami on future donations to charity, however, our findings suggest an inverse relationship with the largest inverse association with donations to needy and caring organizations.

### **Social Jealousy and Stigma: Negative Externalities of Social Assistance Payments in Germany**

**Presented by: Sonja Kassenboehmer, RWI Essen** (John P. Haisken-DeNew; University of Bochum)

This paper examines the role of social assistance payments (SAP or Sozialhilfe) in determining levels of life satisfaction in Germany using the SOEP 1995-2004. We find strong evidence that individuals in Germany are negatively influenced by increased SAP payments controlling for income, whether or not they actually receive such payments (stigma and social jealousy). While there are obvious benefits to making SAP to those needy, there are substantial negative externalities experienced by those who neither receive SAP nor qualify (counterfactual SAP). Furthermore, these negative effects are even stronger for those who do receive benefits (stigma) suggesting that social jealousy and stigma are a force to be reckoned with when evaluating social policy.

### **Changing Identity: The Evolution of Social Groups**

**Presented by: Alan Kirman, EHESS, Université Paul Cézanne** (Ulrich Horst, Humboldt University and Miriam Teschl, University of Cambridge)

Homo Oeconomicus has progressed from an atomistic and self-interested individual to a socially embedded agent in modern economics. What a person chooses is influenced by the group he belongs to. In this paper we suggest that individuals know who they would like to be. We present a social interaction model where people, in part, choose their identity. People choose their social group and move towards the typical characteristics of that group. However, groups will be modified as this happens. Members may then revise their previous choices and possibly choose different groups. The model thus presents an endogenous interaction structure which leads to endogenous group formation and endogenous evolution of personal identity. We characterise the equilibria of this dynamic process.

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## **Session 38: Public Economics II**

**Session Chair: Alexander Haupt, University of Plymouth**

**Room: AP 2**

**Date: March 30, 2010**

**Time: 18:05 - 19:35**

### **Tax Compliance: The Beckerian Analysis Revisited**

**Presented by: Matthew Rablen, University of Westminster**

The Beckerian approach to tax compliance models the tax authority as a law enforcer that maximizes voluntary compliance by trading-off audit probability against the fine rate on undeclared tax. This paper extends the Beckerian approach to allow an alternative characterization of the tax authority as a revenue raiser that maximizes expected revenue by trading-off audit probability against audit effectiveness. I find that the tax authority's privately optimal audit strategy does not maximize voluntary compliance, and that voluntary compliance is non-monotonic as a function of the tax authority's budget. Last, the privately optimal effective fine rate on undeclared tax does not exceed two at interior optima.

### **Optimal Income Tax under the Threat of Migration by Top-Income Earners**

**Presented by: Laurent Simula, Uppsala University** (Alain Trannoy, GREQAM-IDEP)

We examine how allowing individuals to emigrate to pay lower taxes changes the optimal nonlinear income tax scheme in a Mirrleesian economy. An individual emigrates if his domestic utility is less than his utility abroad, net of migration costs - utilities and costs both depending on productivity. A simple formula, that complements Saez's formula obtained in closed economy, is derived for the marginal tax rates faced by top-income earners. It depends on the labour elasticity, the tax rate abroad and the migration costs expressed as a fraction of the utility obtained abroad. The Rawlsian marginal tax rates, obtained for the whole population, illustrate a curse of the middle-skilled. Simulations are provided for the French economy.

### **A Model of Public Consultation**

**Presented by: Kohei Kawamura, University of Edinburgh**

This paper studies information transmission between multiple agents with heterogeneous preferences and a welfare maximizing decision maker who chooses the quality or quantity of a public good (e.g. provision of public health service; carbon emissions policy) that is consumed by all of them. Communication in such circumstances suffers from the agents' incentive to "exaggerate" their preferences relative to the average of the other agents, since the decision maker's reaction to each agent's message is weaker than in one-to-one communication. As the number of agents becomes larger the quality of information transmission diminishes. The use of binary messages (e.g. "yes or no") is shown to be a robust mode of communication when the main source of informational distortion is exaggeration.

### **The Role of Mobility in Tax and Subsidy Competition**

**Presented by: Alexander Haupt, University of Plymouth** (Tim Krieger; University of Paderborn)

In this paper, we analyse the role of mobility in tax and subsidy competition. Our primary result is that increasing 'relocation' mobility of firms leads to increasing 'net' tax revenues under fairly weak conditions. While enhanced relocation mobility intensifies tax competition, it weakens subsidy competition. The resulting fall in the governments' subsidy payments over-compensates the decline in tax revenues, leading to a rise in net tax revenues. We derive this conclusion in a model in which two governments are first engaged in subsidy competition and thereafter in tax competition, and firms locate and potentially relocate in response to the two political choices.



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## **Session 39: Money, Credit and Liquidity**

**Session Chair: Michele Lenza, European Central Bank**

**Room: 32 MS 03**

**Date: March 30, 2010**

**Time: 18:05 - 19:35**

### **Monetary Transmission to UK Retail Mortgage Rates before and after August 2007**

**Presented by: Jack Rogers, University of Exeter**

Do UK banks use discounted and fixed mortgages to entice inert borrowers into competitive deals, which later become uncompetitive? I investigate the extent to which different types of retail mortgage rates are set in a competitive way, using a single-equation error correction model (SEECM) framework, from 1995 to 2009. I also document the economy-wide effect of the financial market turmoil since August 2007 on these relationships. Some of the results show that discounted and fixed mortgage rates do behave dynamically in a more competitive way than standard variable rates (SVRs). I also find asymmetry for SVRs, which take longer to return to their equilibrium with wholesale rates during times when they are relatively expensive than vice versus.

### **Money and Liquidity Effects: Separating Demand from Supply**

**Presented by: Jagjit S. Chadha, University of Kent** (Luisa Corrado; Cambridge and Tor Vergata)

In the canonical monetary policy model, money is endogenous to the optimal path for interest rates and output. But when liquidity provision by banks dominates the transactions demand for money from the real economy, money is likely to contain information for future output because of its impact on financial spreads. And so we decompose broad money into primitive demand and supply shocks. We find that supply shocks have played a significant role in the time series of the money stock in the USA, UK and Eurozone in the short to medium term. We further consider to what extent the supply of broad money is related to policy or to liquidity effects from financial intermediation.

### **Money, credit, monetary policy and the business cycle in the euro area**

**Presented by: Michele Lenza, European Central Bank** (Domenico Giannone; ECARES-Université Libre de Bruxelles and Lucrezia Reichlin; London Business School)

This paper has two objectives. First, to develop a model suitable for the analysis of the transmission mechanism of monetary policy across real, nominal, credit and monetary variables in the euro area using the highest possible level of disaggregation and with the longest available sample of monthly data (sample). Second, analyze the cyclical behavior of disaggregated loans and monetary aggregates with a particular emphasis to the last recession.

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## **Session 40: Labour Market Insecurity**

**Session Chair: Ingo Geishecker, Georg-August-Universität Göttingen**

**Room: 33 MS 03**

**Date: March 30, 2010**

**Time: 18:05 - 19:35**

### **Fears and realisations of employment insecurity**

**Presented by: Andy Dickerson, University of Sheffield** (Francis Green; University of Kent)

We investigate the validity of subjective data on expectations of job loss and on the probability of re-employment consequent on job loss, by examining associations between expectations and realisations. On average, employees overestimate the chance of losing their job by a factor of approximately two; however, they also overestimate the chance of finding another job as good as the currently-held one by nearly a third. Nevertheless, the subjective expectations data reveal private information about subsequent realisations. As predictors of subsequent job loss, the expectations data perform better with cardinal numerical descriptors than with ordinal verbal descriptors. We recommend that survey items on employment insecurity should be explicit about each risk under investigation and utilise a cardinal probability scale.

### **Job Insecurity, Employability, Unemployment and Well-Being**

**Presented by: Francis Green, University of Kent**

This paper shows that employability strongly moderates the effects of unemployment and of job insecurity on well-being. Fixed-effects estimates from panel data show that unemployed people with little hope of finding a job enjoy the least well-being, while employed people who are both highly employable and in a secure job enjoy the most. In between there is substantial differentiation according to employability, job insecurity and their interaction. Compared to a secure job the deleterious effects of high job insecurity on well-being are comparable to the effects of unemployment. Both are substantial. The findings are used to compute estimates of the well-being trade-off between increases in job insecurity and increases in employability, relevant to the support of “flexicurity” policies.

### **Scarring, Habituation and Job Flexibility: Work Histories in Secure and Insecure Employment.**

**Presented by: Colin Green, Lancaster University** (Gareth Leeves; University of Queensland)

Increases in the use of flexible employment contracts create more frequent transitions between unemployment and employment. This paper analyses the impact of cumulative unemployment experiences on the life satisfaction of Australian male workers in flexible employment. Using panel data techniques, it was found that permanent contract workers were scarred by previous unemployment. This contrasted with flexible contract workers who appear habituated to the effects of past unemployment. Social norming effects were evident for permanent workers, unemployment scarred deeper when it was less of a general norm, this was not the case for flexible workers. Flexible contract workers habituation to past unemployment and lack of social norming could contribute to the process of social exclusion.

### **Perceived Job Insecurity and Well-Being Revisited: Towards Conceptual Clarity**

**Presented by: Ingo Geishecker, Georg-August-Universität Göttingen**

This paper analyzes the impact of job insecurity perceptions on individual well-being. While previous studies on the subject have used the concept of perceived job insecurity rather arbitrarily, the present analysis explicitly takes into account individual perceptions about both the likelihood and the potential costs of job loss. We demonstrate that any model assessing the impact of perceived job insecurity on individual well-being potentially suffers from simultaneity bias yielding upward-biased coefficients. When applying our concept of perceived job insecurity to concrete data from a large household panel survey we find the true unbiased effects of perceived job insecurity to be more than twice the size of estimates that ignore simultaneity.

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## **Session 41: Growth Theory**

**Session Chair: Tommaso Gabrieli, University of Reading**

**Room: 02 AC 01**

**Date: March 30, 2010**

**Time: 18:05 - 19:35**

### **Modelling the folk theorem of spatial economics: a heterogeneous regional growth model**

**Presented by: Torben Klarl, University of Augsburg**

The "folk theorem of spatial economics" (fse) states, that increasing returns to scale are essential for explaining the uneven economic distribution of specific economic activity. Thus, the aim of this paper is, to introduce a spatial regional growth model, which links first time knowledge spillover, agglomeration, distribution of per capita productivity and the grasp of spillovers. Further, it is shown in a simulation study, how different regimes of returns to scale and grasps of knowledge affect agglomeration and distribution of per capita productivity. One of the findings is that grasp of knowledge affects dynamic distribution of per capita productivity. Moreover, the simulation study particularly finds support for the (fse).

### **Global Indeterminacy in the Chamley Model of Endogenous Growth in Correspondence of a Bogdanov-Takens Singularity**

**Presented by: Giovanni Bella, University of Cagliari**

Using an explicit center manifold reduction, we set up a general framework to explore the global dynamics of Chamley's model of endogenous growth in the vicinity of a Bogdanov-Takens singularity. For parameter specifications close to the bifurcation values, a number of interesting results emerge. The bifurcation set and the phase portraits give further useful details on the global behavior of the trajectories, in the vicinity of the singularity. To our scopes, particularly interesting appears the possibility of global indeterminacy associated to either Andronov-Hopf bifurcations (either supercritical or subcritical) or saddle-connections. Also global indeterminacy of dimension 1, associated with heteroclinic orbits, can be obtained for specific values of the bifurcation parameters.

### **Development, Growth and Volatility**

**Presented by: Alessio Moro, University of Cagliari; Bank of Spain**

Economies at advanced stages of development grow slower than economies at middle stages; richer economies are less volatile than poorer ones; the share of services in GDP increases with income. When TFP growth and volatility is equal in manufacturing and services at the gross output level, the larger share of intermediate goods in manufacturing implies a larger growth and volatility of TFP at the value added level in manufacturing. Numerical results suggest that the same gross output TFP process in manufacturing and services implies a growth rate and a volatility of GDP 9% larger in an economy with a share of services in GDP of 0.54 (middle income) with respect to an economy with a share of 0.72 (high income).

### **Inequality, Intergenerational Mobility and Redistributive Policies under Endogenous Information**

**Presented by: Tommaso Gabrieli, University of Reading**

This paper presents a dynamic model in order to study how different levels of information about the determinants of wealth (luck versus effort) can impact inequality and intergenerational mobility through societal beliefs, individual choices and redistributive policies. In this dynamic model individual skills are stochastic and both beliefs and voted redistribution are determined endogenously. The framework allows to analyze various comparative statics in order to answer to policy questions. The model generates multiple equilibria (US versus Europe-type) which may account for the observed features not only in terms of societal beliefs and redistribution but also in terms of inequality and perceived versus real mobility.

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## **Session 42: Political Economy**

**Session Chair: Manasa Patnam, University of Cambridge**

**Room: 72 MS 03**

**Date: March 30, 2010**

**Time: 18:05 - 19:35**

### **Dancing the H-Street Waltz? Policy Choice in Aid-Dependent Countries**

**Presented by: Rune Hagen, University of Bergen**

Current aid rhetoric emphasises the selective allocation of otherwise unconditional funds in support of recipients' own plans, in contrast to the old donor practice of bundling money and policies together. When recipients have private policy-relevant knowledge such a regime might result in ownership, but conformity in policy-choice is a real danger. The lure of generous aid might induce recipients to adapt to outcome-oriented donors' expectations, making the latter anticipate sizeable impact even when the former thinks there will be less bang for the aid-buck. Disagreements over the right model of the economy may then produce better results than groupthink. Both competition and coordination among donors can also alleviate this problem, for which there is an abundance of case-study evidence.

### **Power, Politics and Public Good Provision: Understanding Institutional Persistence in Rural Punjab**

**Presented by: Manasa Patnam, University of Cambridge**

This paper examines the long run impact of institutions, collective action and elite power on public good outcomes. Exploiting institutional variation brought about due to canal colonization in Pakistan, the paper finds evidence in favor of institutional persistence. Using detailed village censuses, household survey data, colonial period maps and Geographic Information System, we find that areas that were settled with a more equal distribution of land holding have better access to services. Moreover, within villages, groups that are dominated by elites are more likely to receive public goods. To formalize the result, the paper develops a model wherein it is shown that small but influential groups have higher winning probabilities in cases where group influence is independent of group size.

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## **Session 43: Risk and Choice**

**Session Chair: Bipasa Datta, University of York**

**Room: 39 MS 02**

**Date: March 30, 2010**

**Time: 18:05 - 19:35**

### **Reference-Dependent Risk Preferences of Higher Orders**

**Presented by: Johannes Maier, University of Munich** (Maximilian Ruger; University of Augsburg)

We analyze risk preferences of higher orders, such as the second-order effect of risk aversion, the third-order effect of prudence (downside risk aversion), and the fourth-order effect of temperance (outer risk aversion) in models of reference-dependent preferences. We consider various exogenous as well as endogenous reference points. If the reference point is endogenously formed by expectations, individuals exhibit even- but never uneven-order risk attitudes. By contrast, for reference points which are endogenously formed by regret, uneven- but no even-order effects are present. We use these results to explain empirical patterns of seemingly sub-optimal behavior concerning precautionary saving and insurance demand.

### **Information Acquisition Chains**

**Presented by: Jungsuk Han, London Business School**

This paper studies a finite-horizon overlapping generations model where agents endogenously acquire information on a risky asset of which fundamental value fluctuates due to new fundamental shocks. The result shows that fundamental shocks of high magnitude in the future may eliminate the incentive of acquiring information in earlier periods, thereby breaking "information acquisition chain" from the earliest generation. The result gives a prediction regarding price delay to information as well as extra impact of fundamental shocks such that an extra fundamental shock could result in amplified fundamental uncertainty in the present without having an immediate effect on the current fundamentals.

### **An Incentive Mechanism for Using Risk Adjuster to Reimburse Health Care Providers**

**Presented by: Bipasa Datta, University of York** (Charles Yan, Institute of Health Economics, Canada)

Most often, health care providers are universally reimbursed by health care purchasers. Faced with risk selection challenges, risk adjustment methods are introduced into the reimbursement schemes. However, health care providers then have incentives to manipulate the risk elements trying to secure larger payments i.e. the realisation of risk adjuster then becomes sensitive to the providers' upcoding behaviour. Whilst there is usually an outside auditor who monitors providers' behaviour, monitoring such behaviour is highly costly. We propose a reward scheme to combat such problems. We show that under appropriate incentive schemes, the honest provider obtains higher expected utility while receiving the same reward compared to the full information case. Further, with contractible treatment intensity, the contract resembles the full information one.

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## **Session 44: Contracts and Insurance**

**Session Chair: Christine Ho, University College London**

**Room: 75 MS 02**

**Date: March 30, 2010**

**Time: 18:05 - 19:35**

### **A Dynamic Model of Altruistically-Motivated Transfers**

**Presented by: Daniel Barczyk, New York University** (Matthias Kredler; Universidad Carlos III Madrid)

Inter-vivos transfers constitute a quantitatively important mechanism of insurance, but their timing and influence on savings decisions are poorly understood. We develop a dynamic theory of voluntary transfers in a Markov-perfect setting with two infinitely-lived agents who are imperfectly altruistic. The agents' savings decisions are not Pareto-efficient since agents do not want to induce the other person to overconsume on their expense. As in the well-known static model of altruism, transfers are positively related to the donor's wealth and negatively related to the recipient's assets. Unlike in other dynamic theories of partial insurance, agents continue to receive transfers even when they are not able to reciprocate them in the future.

### **Dynamic Optimal Redistributive Taxation with Endogenous Retirement**

**Presented by: Jean-Baptiste Michau, London School of Economics & Political Science**

While the participation decision is discrete in a static context, i.e. to work or not to work, such is not the case in a dynamic context where workers choose the fraction of their lifetime that they spend working. In this paper, I therefore characterize the optimal redistributive policy in a dynamic environment with both an intensive and an extensive margin to labor supply. The government should optimally design a history-dependent social security system which induces higher productivity individuals to retire later. Redistribution should be done through the social security system rather than with a non-linear income tax.

### **Intensifying the Use of Benefit Sanctions - An Effective Tool to Activate Welfare Recipients?**

**Presented by: Thomas Walter, ZEW Centre for European Economic Research** (Bernhard Boockmann; Institute for Applied Economic Research (IAW), Tübingen Stephan L. Thomsen; Otto-von-Guericke-University Magdeburg and Centre for European Economic Research (ZEW), Mannheim)

In Germany's welfare system, benefit sanctions are not imposed uniformly when recipients do not comply with their duties. Rather, there is substantial discretion at agency level: some agencies frequently impose sanctions whereas others do not. Based on unique data we use differences in sanction strategies and rates across welfare agencies as instrumental variables to estimate the effect of a sanction on dropout from welfare and transition to employment. Specifically, we estimate the sanction effect on individuals not sanctioned in agencies with a moderate sanction policy but sanctioned in agencies with a tough regime. This effect gives an estimate of the effectiveness of an intensified use of sanctions. Our results show that intensifying the use of sanctions would be quite effective.

### **Optimal Disability Insurance with Informal Child Care**

**Presented by: Christine Ho, University College London**

We analyse optimal disability insurance in the presence of unobserved health shocks and informal child care activities. We show how a combination of lump sum taxation and child care subsidies can implement the constrained efficient allocation. In the case of multiple health types, the optimal subsidies follow a sliding scale with increasing subsidies for lower family types. We then calibrate an overlapping generations model with child care needs to the US economy. Optimal benefits are higher for families with higher child care needs. Optimal average tax rate is lower for healthy families as compared to the US average tax rate and vice versa for disabled families. We also find that adopting the optimal scheme can lead to sizeable cost savings.

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## **Session 45: Sovereign Debt**

**Session Chair:** Cesar Sosa Padilla, University of Maryland

**Room:** 80 MS 02

**Date:** March 30, 2010

**Time:** 18:05 - 19:35

### **Delay and Haircuts in Sovereign Debt: Recovery and Sustainability**

**Presented by:** Kannika Thampanishvong, University of St Andrews (Sayantan Ghosal; University of Warwick and Marcus Miller; University of Warwick)

A striking aspect of recent sovereign debt swaps is that, conditional on default, long delay is positively correlated with size of the haircut. In this paper, we develop a model of debt restructuring to account for this -- highlighting economic recovery and sustainability as complementary reasons for delay. We show how growth (recovery) and sustainability together can explain multi-period delay, due initially to wait for recovery and then to permit debtor to signal about the sustainability concern. We argue that it is the extension of delay that leads to the larger haircut.

### **Long-run Behaviour of Long-term Sovereign Bond Yields**

**Presented by:** Antonio Afonso, ECB (Christophe Rault, University of Orleans)

This study assesses the long-run behaviour of long-term sovereign bond yields in OECD countries, for the period 1973-2008. We employ a dynamic panel approach, to reflect financial and economic integration, and to increase the performance and accuracy of the tests. Given the existence of cross-country dependence regarding the sovereign bond segment of the financial markets and its determinants, we resort to simulation and bootstrap methods for the analysis. Results show that in addition to credit and liquidity risk, and common movements in sovereign yields, investors also consider country differences arising from specific factors (inflation, budgetary and current account imbalances, and real effective exchange rates).

### **Sovereign Debt Default: The Impact of Creditor Composition**

**Presented by:** Amrita Dhillon, University of Warwick (Javier Garcia-Fronti: University of Buenos Aires and Lei Zhang; University of Warwick)

The main motivation of this paper is to study the impact of the composition of creditors on the probability of default and the risk premium on sovereign bonds, when there is debtor moral hazard. In the absence of any legal enforcement, relational contracts work only when there are creditors who have a repeated relationship with the borrower. We show that ownership structures with a larger fraction of long term lenders are associated with a lower default probability and lower risk premia. Moreover, competitive markets structures lead to loss in efficiency as well when there is moral hazard, in contrast to the case with perfect enforceability and information.

### **Commitment, debt dilution, and overborrowing**

**Presented by:** Cesar Sosa Padilla, University of Maryland (Juan Carlos Hatchondo; Federal Reserve Bank of Richmond Leonardo Martinez; IMF Institute)

We propose an extension of a baseline sovereign default framework that allows us to study the case in which the government commits to eliminating future overborrowing implied by debt dilution. The comparison of the results obtained assuming commitment and the ones obtained with the baseline framework allows us to measure the overborrowing implied by dilution and its consequences. We find that overborrowing accounts for almost 100% of the sovereign interest rate spread and 12% of the mean debt level. In addition, reasonable calibrations without overborrowing cannot deliver spreads of the magnitude of those observed in the data. This can be interpreted as evidence of the emerging market sovereigns' lack of institutions that allow them to curb incentives to dilute their debt.

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## **Session 46: Search and Matching**

**Session Chair: Jesper Bagger, Royal Holloway, University of London**

**Room: 81 MS 02**

**Date: March 30, 2010**

**Time: 18:05 - 19:35**

### **A dynamic demand model with consideration set formation**

**Presented by: Stephan Seiler, London School of Economics**

Prices for grocery items differ across stores and time because of promotion periods. Consumers therefore have an incentive to search for the lowest price. When a product is purchased infrequently though, the hassle of checking the price on every shopping trip might outweigh the benefit of spending less. I propose a structural model for storable goods, that takes inventory holdings and search into account. The model is estimated using data on laundry detergent purchases. I find that search costs play a large role in explaining purchase behaviour, with a large proportion of consumers not being aware of the price of detergent in a given time period.

### **Ability to Search and Price Dispersion: Evidence from the Internet Motor Insurance Market**

**Presented by: Stephen McDonald, Newcastle University (Colin Wren; Newcastle University)**

The paper analyses the relationship between price dispersion and the ability to search using a non-sequential search model, where ability is measured by Internet usage. The model predicts a negative relationship between search ability and price dispersion, which is estimated using a dataset for the UK Internet motor insurance market. This comprises premium data for consumer types that vary in their Internet use, according to age, occupation and sex. Allowing for risk and propensity to search, the paper finds that search ability has a negative effect on price dispersion.

### **Non-Random Search on the Internet**

**Presented by: Andrew Rhodes, University of Oxford**

Consumer search on the internet is rarely random. Sponsored links appear higher up a webpage and consumers often click them. Firms also bid aggressively for these 'prominent' positions at the top of the page. But why should prominence matter, when visiting an additional website is almost costless? I show that if consumers know what products are available, they usually only search a few firms. Less prominent firms charge higher prices because they only get visited by consumers who value their product highly. This discourages many consumers from searching them, so they earn significantly lower profits than prominent retailers.

### **Wage and Productivity Dispersion: Labor Quality or Rent Sharing?**

**Presented by: Jesper Bagger, Royal Holloway University of London (Bent Jesper Christensen; Aarhus University and Dale T. Mortensen; Northwestern University)**

Wage and labor productivity differ across firms, and more productive firms pay higher wages. We consider a rent sharing model that allows for differences in capital, labor quality and stochastic TFP and estimate it on Danish matched employer-employee data. For Manufacturing, 42% of dispersion in log value added per worker is attributable to firm differences in capital intensity, 36% stems from TFP differences and only 9% from quality differences in labor inputs. Over 70% of individual log wage dispersion stems from firm differences and only 13% from individual characteristics. Our results suggest major gains to reallocation of labor across firms. This reallocation is enhanced by job search motivated by rent sharing.



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## **Session 47: Exchange Rates**

**Session Chair: Christoph Himmels, University of Exeter**

**Room: 01 AC 01**

**Date: March 30, 2010**

**Time: 18:05 - 19:35**

### **Limits of Floats: The Role of Foreign Currency Debt and Import Structure**

**Presented by: Sebastian Weber, Graduate Institute** (Pascal Towbin; Graduate Institute of International and Development Studies)

A traditional argument in favor of flexible exchange rates is they insulate output better from real shocks, because the exchange rate can adjust and stabilize demand through expenditure switching. This argument is weakened in a model with high foreign currency debt and low exchange rate pass through to import prices. We analyze the transmission of real external shocks to the domestic economy under different exchange rate regimes for 101 countries in a Panel VAR and let the responses vary with foreign indebtedness and import structure. We find that flexible exchange rates do not insulate output better from external shocks if the country imports mainly low pass-through goods and can even amplify the output response if foreign indebtedness is high.

### **The interest rate -- exchange rate nexus: exchange rate regimes and policy equilibria**

**Presented by: Christoph Himmels, University of Exeter** (Tatiana Kirsanova; University of Exeter)

We study a credible Markov-perfect monetary policy in an open New Keynesian economy with incomplete financial markets. We demonstrate the existence of two discretionary equilibria. Following a shock the economy can be stabilised either 'quickly' or 'slow', both dynamic paths satisfy conditions of optimality and time-consistency. The model can help us to understand sudden change of the interest rate and exchange rate volatility in 'tranquil' and 'volatile' regimes even under a fully credible 'soft peg' of the nominal exchange rate in developing countries.

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## **Session 48: Optimal Monetary Policy**

**Session Chair: Tatiana Damjanovic, University of St. Andrews**

**Room: AP 1**

**Date: March 31, 2010**

**Time: 9:15 - 10:45**

### **Do Real Balance Effects Invalidate the Taylor Principle in Open Economies?**

**Presented by: Alexander Mihailov, University of Reading** (Stephen McKnight; University of Reading)

This paper derives the necessary and sufficient conditions for local equilibrium determinacy in a two-country Neo-Wicksellian model that incorporates real balance effects. It is shown that the Taylor principle remains valid in preventing indeterminacy of equilibrium provided monetary policy is characterized by a forecast-based domestic price inflation rule.

### **The Role of Financial Market Structure and the Trade Elasticity for Monetary Policy in Open Economies**

**Presented by: Katrin Rabitsch, Central European University and Magyar Nemzeti Bank**

This paper studies Ramsey optimal monetary policy in a two-country model with monopolistic competition and nominal rigidities under different assumptions on international financial markets: complete markets, financial autarky, incomplete markets-bond economy. I show that the optimality of (producer) price stability and inward-looking policies is only obtained in the special case in which risk sharing is complete and policymakers act coordinately. In all other cases, movements in international relative prices enter into the consideration of optimal monetary policy. I show how these optimal deviations from price stability depend on the degree of risk sharing a particular financial market structure provides and on the trade elasticity. Contrasting Nash and coordination policies I show that there are generally welfare gains from coordination to be achieved.

### **Second order accurate approximation to the Rotemberg model around a distorted steady state**

**Presented by: Tatiana Damjanovic, University of St. Andrews** (Charles Nolan; University of St. Andrews)

Less is known about social welfare objectives when it is costly to change prices, as in Rotemberg (1982), compared with Calvo-type models. We derive a quadratic approximate welfare function around a distorted steady state for the costly price adjustment model. We highlight the similarities and differences to the Calvo setup. Both models imply inflation and output stabilization goals. It is explained why the degree of distortion in the economy influences inflation aversion in the Rotemberg framework in a way that has no counterpart in the Calvo setup.

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## **Session 49: Econometrics**

**Session Chair: Carlo Altavilla, University of Naples Parthenope**

**Room: 03 MS 01**

**Date: March 31, 2010**

**Time: 9:15 - 10:45**

### **Bootstrap Unit Root Tests for Nonlinear Threshold Models**

**Presented by: Dilem Yildirim, Middle East Technical University** (Ralf Becker; University of Manchester and Denise Osborn; University of Manchester)

While many unit root testing procedures have been developed to account for nonlinearity, almost all available tests assume a linear DGP under the unit root null hypothesis. This paper proposes two new unit root tests that allow the process to be nonlinear under the null hypothesis. More specifically, block and model-based bootstrap procedures are developed for smooth transition threshold models. Simulations show that the latter is preferred and the model-based bootstrap test delivers a good size performance across all specifications, including linear and abrupt transition models. The model-based test also dominates the standard ADF test in terms of power and an application to the US unemployment rate shows that it can overturn conclusions based on an erroneous linearity assumption.

### **GMM, Generalized Empirical Likelihood and Time Series**

**Presented by: Federico Crudu, University of Groningen**

In this paper we extend the results of Kitamura (1997) for BEL to the more general class of GEL estimators. The resulting BGEL estimator is proved to be consistent and asymptotically normal and attains the semiparametric lower bound. In addition, we define the BGEL version of the classical trinity of tests, Wald, Lagrange Multiplier, and Likelihood Ratio tests. The resulting tests are as expected chi square distributed. We find via Monte Carlo experiments that the over identification tests that stem from the BGEL estimator have generally better small sample properties than the J test.

### **Hypothesis Testing of Multiple Inequalities : The Method of Constraint Chaining**

**Presented by: Le-Yu Chen, Academia Sinica** (Jerzy Szroeter; UCL)

We discuss key properties which tests of multiple inequality hypotheses should satisfy: (1) asymptotic exactness, (2) asymptotic similarity on the boundary, (3) absence of nuisance parameters from the asymptotic null distribution, (4) availability of an explicit formula for the asymptotic null distribution and negligible computer-intensive implementation cost, (5) generality of test assumptions to cover covariance singularities. Current tests do not satisfy all five properties. We propose a nontrivial test which does. We introduce a method called constraint chaining which begins by writing multiple inequalities as a single equality using zero-one indicators. We then smooth these indicators. The obtained approximate equality is the basis of a well-behaved test. A full asymptotic theory is developed. Simulations show that the test performs well.

### **Information combination and forecast (st)ability. Evidence from vintages of time-series data**

**Presented by: Carlo Altavilla, University of Naples Parthenope** (Matteo Ciccarelli; European Central Bank)

This paper explores the role of model and vintage combination in forecasting, with a novel approach that exploits the information contained in the revision history of a given variable. Instead of following the common practice of investigating only the relationship between first available and fully revised data, we analyse the entire revision history for each variable and extract a signal from the entire distribution of vintages of a given variable to improve forecast accuracy. The results suggest that augmenting the information set with a signal extracted from all available vintages of time-series consistently leads to a substantial improvement in forecast accuracy, precision and stability.

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## **Session 50: Asset Prices, Risk and Portfolios**

**Session Chair: Sergejs Saksonovs, University of Cambridge**

**Room: AP 2**

**Date: March 31, 2010**

**Time: 9:15 - 10:45**

### **Measuring risk contagion and interdependence: CoVaR**

**Presented by: Silvia Miranda Agrippino, Bocconi University**

This paper distinguishes between interdependence and contagion in the context of risk spillovers among financial institutions. Sharing the definition of the CoVaR with Adrian and Brunnermeier (2009), we deliver a measure of exposure to risk and provide insights regarding the vulnerability of the financial system. Using daily equity returns data on commercial banks we describe a way to achieve the identification of the relationship of dependence between each bank and the system jointly modelling the conditional covariances via a bivariate model. Conditional and unconditional VaR show that there is strong evidence of both interdependence and contagion within the financial system and that therefore the VaR cannot be used as a unique measure of risk especially during periods of financial instability.

### **The public Limit Order Book of the Korea Exchange: Market capitalization dependent endogenous effects on spreads, volatility and volume**

**Presented by: Thu Phuong Pham, University of Sydney** (Peter L. Swan; University of New South Wales and Joakim Westerholm; University of Sydney)

In 1999 the Korea Exchange [KE] provides important information for exchanges that are deciding between a transparent market, preferred by most participants, and an anonymous market accommodating large institutions and their brokers. Using several alternative metrics for market quality and estimation methodology accounting for fixed firm effects and endogeneity in explanatory variables, our results contradict previous research, which mostly supports the drive for opacity. We find that when limit orders are public, spreads fall, volatility increases and volume increases. The effects differ across market capitalization segments. The current policy of the Korean Stock Exchange to publicly display the 10 best orders, including broker identity and trades is provisionally best practice, as it promotes higher traded volume.

### **A Structural Econometric Analysis of Polish Treasury Bill Auctions**

**Presented by: Daniel Marszalec, Nuffield College, University of Oxford**

We apply two structural econometric models, the non-parametric model of Hortacsu (2002), and the semi-parametric model of Février, Preget & Visser (2002), to Polish treasury-bill auction data. Our paper has three main aims: firstly, to compare the performance of discriminatory and uniform-price auctions in Poland, and secondly, to evaluate the mutual (in)consistencies of predictions from the two models. The third contribution is that we take data from top-up auctions seriously: in the Hortacsu model, we outline how such data can be used to check consistency on estimated valuation functions. We conclude that both models favour the discriminatory auction over uniform-price.

### **Explaining Cross-Border Asset Allocation: A Multi-Country Model with Preference Heterogeneity**

**Presented by: Sergejs Saksonovs, University of Cambridge**

This paper creates a tractable international business cycle model with a special focus on net foreign asset composition. The model allows for an arbitrary number of countries with heterogeneous preferences and a menu of assets that includes both bonds and equities with returns denominated in different currencies and risk premia. The model can successfully match the signs of net asset positions in debt and equity for the US, euro area, Japan and the UK. Allowing for heterogeneous preferences is shown to improve the performance of the model. The paper also provides theoretical solutions for optimal net foreign asset composition under different assumptions on preferences and stochastic environment.

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## **Session 51: Commodity and Energy Prices**

**Session Chair: Paul Alagidede, University of Stirling**

**Room: 32 MS 03**

**Date: March 31, 2010**

**Time: 9:15 - 10:45**

### **Price transmission in the UK electricity market: was NETA beneficial?**

**Presented by: Michael Waterson, University of Warwick** (Monica Giuliatti; Nottingham University Business School and Luigi Grossi; University of Verona)

This paper explores the relationship between domestic retail electricity prices in Great Britain and their determinants in the particular context of the New Electricity Trading Arrangements (NETA) introduced in 2001. We employ a consistent comparison of wholesale power price series before and after NETA, alongside a difference-in-differences analysis based on using Scotland as a control. Despite NETA's stated intention of reducing wholesale and thereby retail prices, we conclude that its net effect, alongside other developments, instead merely rearranged where money was made in the system.

### **Operational and Investment Response to Energy Prices in OECD Manufacturing: Evidence from the Vintage Capital Model**

**Presented by: Jevgenijs Steinbuks, University of Cambridge** (Karsten Neuhoff; DIW)

This paper adopts vintage capital approach to analyze the effect of energy prices on energy efficiency, separately accounting for operational and investment choices in different sectors. The empirical model is estimated for 19 OECD countries across five manufacturing industries over the period 1990-2005. Vintage representation of capital stock significantly improves the explanatory value of the model at the industry level. Estimated own-price operational elasticities of energy demand vary between 0.26 and 1.00 and are economically sound. Estimated own-price investment elasticities of energy efficiency of capital stock vary between 0.03 and 0.9. The results of policy simulations for the U.K. petrochemical industry indicate that total own-price elasticity of energy demand is close to one.

### **Non-discrimination clauses in the retail energy sector**

**Presented by: Morten Hviid, University of East Anglia** (Catherine Waddams Price, University of East Anglia)

The energy regulator in the UK is imposing a non-discrimination requirement on energy retailers to ensure that retailers charge the same mark-up in different regions. Each region is characterised by a former regional (electricity) incumbent, a former national (gas) incumbent and several entrants who are (electricity) incumbents in other regions. A significant number of consumers are loyal to firms with incumbency status, necessitating heavy discounting by entrants to attract customers and leading to regional price discrimination. We confirm theoretically that banning such discrimination will increase some prices and is likely to increase all. We identify the relative impact of the policy on those consumers whom Ofgem considers vulnerable and for whose protection the new licence conditions were introduced.

### **Trends, cycles and seasonal components in primary commodity prices**

**Presented by: Paul Alagidede, University of Stirling**

In this paper we propose structural time series models in which trends, cycles and seasonal components are treated as stochastic and which contains the traditional approach as a special case. Cast in state space form, and estimated using maximum likelihood via the Kalman filter, these models accurately predict the behaviour of primary commodity prices through time. We found that the individual dgp have varied over time and are best captured as stochastic rather than deterministic trends. Moreover, we uncover multiple structural breaks and outliers, far beyond what extant results would like us to believe. Finally, the models remain robust in an out of sample forecast.

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## **Session 52: Growth and Development**

**Session Chair: Miguel St. Aubyn, ISEG/UECE**

**Room: 33 MS 03**

**Date: March 31, 2010**

**Time: 9:15 - 10:45**

### **The Long-Run Effect of Foreign Aid on Domestic Output**

**Presented by: Dierk Herzer, Johann Wolfgang Goethe-University** (Oliver Morrissey; University of Nottingham)

This paper makes two main contributions. First, we examine the long-run effect of foreign aid on domestic output for 59 developing countries using heterogeneous panel cointegration techniques to control for omitted variable and endogeneity bias and to detect possible cross-country differences in the output effect of aid. The main result is that aid has, on average, a negative long-run effect on output, but there are large differences across countries. Second, we use a general-to-specific approach to systematically search for country-specific factors explaining the cross-country differences in the estimated long-run effect of aid. We find that the cross-country heterogeneity in the output effect of aid can be explained mainly by cross-country differences in law and order, religious tensions and government size.

### **Deficit, Seigniorage and the Growth Laffer Curve in developing countries**

**Presented by: Helene Ehrhart, CERDI** (Alexandru Minea; CERDI University of Auvergne and Patrick Villieu; LEO University of Orléans)

The endogenous growth literature has established the existence of an inverted-U curve between taxes and economic growth, namely a Growth Laffer Curve (GLC). We develop a growth model with public investment as the engine of perpetual growth, and look for the effect of deficit, tax and money financing on economic growth. We study in particular the way fiscal and monetary policies (through deficit and seigniorage respectively) deform the GLC. An empirical section based on a panel of developing countries provides GMM-system estimators that support our theoretical conclusions.

### **Quality and Quantity of Education in the Process of Development**

**Presented by: Amparo Castello-Climent, Instituto de Economía Internacional** (Ana Hidalgo-Cabrillana; University Carlos III)

This paper develops a theory showing that educational quality could be an important factor driving dispersion in levels of schooling, and output per capita across countries. The theory states that, even with perfect capital markets, relatively low educational quality discourages investment since it decreases the returns from higher education. As a result, agents get stuck at primary levels, and end up being poor. By contrast, relatively high quality raises opportunities to pursue education beyond primary school. In this case, a greater-quality educational system also translates into higher levels of investment. Using cross country data, empirical evidence shows that the quality of education and its effect on the accumulation of human capital are important factors in the process of development.

### **Public and Private Inputs in Aggregate Production and Growth: A Cross Country Efficiency Approach**

**Presented by: Miguel St. Aubyn, ISEG/UECE** (António Afonso; European Central Bank and ISEG/TULisbon – Technical University of Lisbon)

In a cross section of OECD countries we replace the macroeconomic production function by a production possibility frontier, TFP being the composite effect of efficiency scores and possibility frontier changes. We consider, for the periods 1970, 1980, 1990, 2000, one output: GDP per worker; three inputs: human capital, public physical capital per worker and private physical capital per worker. We use a semi-parametric analysis, computing Malmquist productivity indexes, and we also resort to stochastic frontier analysis. Results show that private capital is important for growth, although public and human capital also contribute positively. A governance indicator, a non-discretionary input, explains inefficiency. Better governance helps countries to achieve a better performance.

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## **Session 53: Business Cycles**

**Session Chair: Fabio Milani, University of California, Irvine**

**Room: 72 MS 03**

**Date: March 31, 2010**

**Time: 9:15 - 10:45**

### **The Costs and Benefits of Informalization in a Two-Sector New Keynesian Model**

**Presented by: Emanuela Lotti, University of Southampton/University of Surrey** (Nicoletta Batini; IMF and University of Surrey and Paul Levine; University of Surrey)

We explore the costs and benefits of informalization in a two-sector New Keynesian model. The informal sector is more labour intensive, is untaxed, has a classical labour market and may be unobserved. The formal sector bears all the taxation costs and wages are determined by a real wage norm. We identify three welfare costs of informalization: (1) Long-term costs restricting taxes to the formal sector (2) Short-term fluctuation costs of tax changes to finance fluctuations in government spending, restricted to the formal sector and (3) Costs associated with a lack of observability of the informal sector. The benefit of informalization derives from its wage flexibility. We investigate whether taxing the informal sector sees a net welfare improvement.

### **Factor Demand Linkages, Technology Shocks and the Business Cycle**

**Presented by: Ivan Petrella, Catholic University Leuven** (Sean Holly; University of Cambridge)

This paper argues that factor demand linkages are crucial in the transmission of both sectoral and aggregate shocks. We show this using a panel of highly disaggregated manufacturing sectors together with sectoral structural VARs. When sectoral interactions are explicitly accounted for, a contemporaneous technology shock to all manufacturing sectors implies a positive response in both output and hours at the aggregate level. Otherwise, there is a negative correlation as in much of the existing literature. Furthermore, we find that technology shocks are important drivers of business cycles.

### **Should We Expect Financial Globalization to have Significant Effects on Business Cycles?**

**Presented by: Jens Iversen, University of Southern Denmark**

Empirical research suggests that financial globalization has insignificant effects on business cycles. Based on standard theoretical models it might be conjectured that the effects should be significant. I show that this conjecture is wrong. Whereas the empirical effects are imprecisely estimated because of short samples the theoretical effects can be determined to any level of precision by expanding the underlying artificial samples. If the theoretical analysis is based on empirically relevant sample sizes, a benchmark international real business cycle model predicts insignificant effects of globalization for many important business cycle statistics. A sensitivity analysis shows that this result holds under alternative model structures. My results suggest that we should not expect financial globalization to have significant effects on business cycles.

### **Expectations Shocks and Learning as Drivers of the Business Cycle**

**Presented by: Fabio Milani, University of California, Irvine**

This paper exploits data on expectations from the SPF to estimate a benchmark New Keynesian model. The observed expectations are modeled as formed from an expectation formation mechanism that assumes that economic agents use a linear PLM for economic variables and that they need to learn model coefficients over time. In addition to the typical structural disturbances, the model incorporates expectation shocks, which affect the formation of expectations by the private sector. The expectations shocks capture waves of optimism and pessimism that lead agents to form forecasts that deviate from those implied by their learning model. The empirical results uncover a crucial role for these novel expectation shocks as a major driving force of the U.S. business cycle.

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## **Session 54: Labour Markets**

**Session Chair: Ronald Bachmann, RWI**

**Room: 39 MS 02**

**Date: March 31, 2010**

**Time: 9:15 - 10:45**

### **Fixing the leak: Unemployment incidence before and after the 2006 reform of unemployment benefits in Germany**

**Presented by: Stephan Dlugosz, ZEW Mannheim** (Gesine Stephan; IAB Institute for Employment Research and University of Erlangen-Nuremberg and Ralf A. Wilke, University of Nottingham, PSI Policy Studies Institute London, and ZEW Centre for European Economic Research Mannheim)

From 2002-2004, the German government passed several laws that curtailed the generosity of the unemployment compensation system. One of the most ambitious changes was a considerable reduction in unemployment benefit entitlement lengths for older unemployed, which was effective during 2006 and 2007. We apply a difference-in-differences approach to show that the highly disputed reform induced a considerable decline in unemployment incidence among older workers. It thus sealed an important leak in the unemployment insurance system. Furthermore, we find a strong anticipation effect; unemployment entries of elderly workers peaked during the months preceding the reform.

### **Evaluating the Labor-Market Effects of Compulsory Military Service: A Regression-Discontinuity Approach**

**Presented by: Alfredo Paloyo, Ruhr Graduate School in Economics** (Thomas K. Bauer; RWI, Ruhr University of Bochum, IZA Bonn Stefan Bender; IAB and Christoph M. Schmidt; RWI, Ruhr University of Bochum, CEPR)

We identify the causal effect of compulsory military service on conscripts' subsequent labor-market outcomes by exploiting the regression-discontinuity design of the military draft in Germany during the 1950s. Unbiased estimates of the effect of military service on lifetime earnings, wages, and employment are obtained by comparing men born before July 1, 1937 (the "White Cohort") who were exempted from compulsory military service to men who were born on or shortly after this threshold date and hence faced a positive probability of being drafted. We find that the putative earnings advantage and wage premium of those who served in the armed forces vanish when selection effects are taken into account.

### **Performance Pay as an Incentive for Lower Absence Rates in Britain**

**Presented by: Nikos Theodoropoulos, University of Cyprus** (Konstantinos Poulidakis, University of Aberdeen Business School and IZA)

Using two cross-sections (1998 and 2004) of a rich representative dataset of British establishments, the effect of various forms of incentive pay (e.g. performance-related pay (PRP), profit-sharing, stock ownership, cash bonuses) on the absence rates of firms are investigated. Incentives that are tightly linked to individual or group merit are found to be significantly related to lower absenteeism. Important disparities in the effect of PRP on absenteeism are detected, which depend on the extent of monitoring, private-public status, teamwork, and other organizational changes. The findings are robust to the potential endogenous relation between monitoring, PRP and absenteeism, and have important implications for the design of optimal compensation policies by firms.



## **Decomposing the Ins and Outs of Cyclical Unemployment**

**Presented by: Ronald Bachmann, RWI** (Mathias Sinning; Australian National University)

We analyse the cyclical nature of the U.S. labour market using a new Blinder-Oaxaca decomposition for logit models which decomposes differences in exit rates out of unemployment between different phases of the business cycle. Our results indicate that, holding characteristics constant, the probability of leaving unemployment to employment falls in a recession. On the other hand, certain characteristics become more important in the pool of the unemployed during a recession, which increases the exit rate out of unemployment. Therefore, the cyclical features of the hazard of transiting from unemployment to employment are entirely due to the behavioural effect, whereas the composition effect plays a dampening role for labour market dynamics.

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## **Session 55: Aspects of Happiness and Satisfaction**

**Session Chair: Fabrice Etilé, INRA**

**Room: 75 MS 02**

**Date: March 31, 2010**

**Time: 9:15 - 10:45**

### **Winning Big but Feeling No Better? The Effect of Lottery Prizes on Physical and Mental Health**

**Presented by: Andrew Clark, PSE** (Benedicte Apouey; University of South Florida)

We use British panel data to explore the exogenous impact of income, via lottery winnings, on general health status, mental health, physical health problems, and health behaviours (drinking and smoking). Positive income shocks have no significant effect on general health, but a large positive effect on mental health. The well-known status gradient in health in cross-section data thus probably reflects the endogeneity of income. We also argue that the zero general health effect comes from increased risky behaviours: lottery winners smoke more and engage in more social drinking. This paper thus presents the first microeconomic analogue of previous work which has highlighted the negative health consequences of good macroeconomic conditions.

### **The effect of pensions on longevity: evidence from Union Army veterans**

**Presented by: Martin Salm, Tilburg University**

This study uses changes in pension laws for Union Army veterans as a natural experiment to estimate the causal effect of pensions on longevity, and to examine potential pathways underlying such a relationship. We examine the effects of the pension laws of 1907 and 1912, which granted old-age pensions to Union Army veterans. Life expectancy for veterans, who received such a pension, increased by 0.8 years and 2.3 years, respectively. The effect of veteran pensions on longevity was large across wealth groups and size of city. Pensions reduced mortality for both acute and non-acute causes of death.

### **Do Danes and Italians rate life satisfaction in the same way? Using vignettes to correct for individual-specific scale biases.**

**Presented by: Viola Angelini, University of Padua** (Danilo Cavapozzi, University of Padua; Luca Corazzini, University of Padua and Omar Paccagnella, University of Padua)

Self-reported life satisfaction is highly heterogeneous across similar countries. This phenomenon can be largely explained by the different scales and benchmarks adopted by individuals when evaluating themselves. Using a dataset representative of the population aged 50 and over in ten European countries, we compare estimates from an Ordered Probit that assumes invariant life satisfaction scales across respondents with those from a Hopit model that uses vignettes to correct for individual-specific scale biases. Variations in response scales explain a large part of the differences found in raw data. Moreover, the cross-country ranking in life satisfaction dramatically depends on scale biases.

### **Happy Spouses! Spousal Weight and Individual Well-Being**

**Presented by: Fabrice Etilé, INRA** (Andrew E. Clark; Paris School of Economics)

We use life satisfaction (LS) and Body Mass Index (BMI) measures from three waves of the GSOEP to test for well-being spillovers in body shape between spouses. Semi-parametric regressions show that partner's BMI is, beyond a certain level, negatively correlated with own satisfaction. Own BMI is positively correlated with LS in thin men, and negatively correlated with LS after some threshold. This threshold increases with partner's BMI when the individual is overweight. The negative well-being impact of partner's BMI is thus lower when the individual is also overweight or obese. This is consistent with contagion effects in weight. However, instrumental variable estimates suggest that the relationship is not causal effects, but reflect rather welfare comparisons between individuals

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## **Session 56: Productivity and Technology**

**Session Chair:** Vincenzo Merella, City University London

**Room:** 80 MS 02

**Date:** March 31, 2010

**Time:** 9:15 - 10:45

### **Do Spillovers Matter When Estimating Private Returns to R&D?**

**Presented by:** Markus Eberhardt, Centre for the Study of African Economics, University of Oxford (Christian Helmers, University of Oxford and Hubert Strauss, European Investment Bank)

This paper asks whether unbiased estimates of private returns to R&D can be obtained within the Griliches knowledge production function when the presence of spillovers is ignored. We adopt a common factor approach, which allows for R&D spillovers without imposing any arbitrary structure on the nature of spillovers and analyse panel data from 12 industrial sectors of 12 OECD countries (1986-2005) to arrive at unbiased estimates of private returns to R&D. Our results indicate the presence of substantial cross-sectional dependence in the residuals of the Griliches knowledge production function. Further, our estimations suggest that when ignoring the presence of cross-sectional dependence R&D produces positive returns. When cross-sectional dependence is accounted for, we find zero private returns to R&D.

### **Technology Adoption and Fuzzy Patent Rights**

**Presented by:** Jing-Yuan CHIOU, IMT Lucca

This paper considers why a patent-holder would have low incentives to reduce the uncertainty of patent boundary. Clearer patent rights, i.e., when patent examination results are more informative about subsequent court decisions, provide better guidance to technology-specific investment and encourage technology adoption. However, under mild conditions the patent-holder's post-adoption payoff is decreasing in clarity. The patent-holder prefers to maintain "fuzzy" patent rights when she wants to monopolize the use of the technology, or when promoting technology diffusion is not a strong concern. The latter happens when the patent-holder, as a pure licensor, has a low (ex ante) quality invention.

### **The Role of Quality Ladders in a Ricardian Model of Trade with Nonhomothetic Preferences**

**Presented by:** Vincenzo Merella, City University London (Esteban Jaimovich; Collegio Carlo Alberto)

The literature on North-South trade explores conditions under which international trade magnifies income disparities between the advanced North and the backward South. Little attention is placed on the effect of trade on countries that do not display substantial dissimilarities concerning aggregate capital endowments. We show that even when no single country is technologically more advanced than any other one and productivity changes are identical in all countries, international trade may be a source of income divergence when nonhomothetic preferences and quality ladders are jointly considered. Income divergence is experienced when comparative advantages induce patterns of specialisation that do not offer the same scope for improvements in terms of subsequent quality upgrading of final products.

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## **Session 57: Industrial and Firm Organisation**

**Session Chair: Maksymilian Kwiek, University of Southampton**

**Room: 81 MS 02**

**Date: March 31, 2010**

**Time: 9:15 - 10:45**

### **Platform Standards, Collusion and Quality Incentives**

**Presented by: Claudia Salim, Free University Berlin**

This paper examines how quality incentives are related to the interoperability of competing platforms. Platforms choose whether to operate standardised or exclusively, prior to quality and subsequent price competition. We find that platforms choose a common standard if they can coordinate their quality provision. The actual investment then depends on the cost of quality provision: If rather high, platforms refrain from investment; if rather low, platforms maintain vertically differentiated platforms. The latter case is socially more desirable than exclusivity where platforms do not invest. Nevertheless, quality competition of standardised platforms induces the highest investment and maximum welfare.

### **Partner or Rival: Entry deterrence with multimarket contact**

**Presented by: Pak Yee Lee, University of Leicester**

This paper analyzes predatory pricing as an entry deterrence tool with multimarket contact. The model considers an incumbent monopolist faces the threat of entry in one of the markets where an entrant and an incumbent compete in quality and price. We show that an incumbent can always defend its monopoly position even when it has cost disadvantage and quality constraint. We find conditions under which incumbent accommodates entry. The accommodation conditions are when (1) the quality of the entrant's product is sufficiently high or (2) the entrant or both firms have sufficiently low marginal costs. The predatory pricing has implication for competition law generally, which are considered.

### **Competition among mass media**

**Presented by: Maksymilian Kwiek, University of Southampton**

This paper investigates how mass media provide information to readers or viewers who have diverse interests. The problem of a mass medium comes from the fact that there is a constraint on how much information can be delivered. It is shown that the mass medium optimally provides information that is somewhat useful to all agents, but not perfect to anybody in particular. This benchmark model is then used to investigate competition among mass media with differentiated products. In the equilibrium of the example studied, mass media differentiate their news fully, as if they were monopolies on the subset of readers to which they tailor their news. However, prices are disciplined by competition.

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## **Session 58: IO and Pricing**

**Session Chair: Zhijun Chen, University of East Anglia**

**Room: 01 AC 01**

**Date: March 31, 2010**

**Time: 9:15 - 10:45**

### **Charity Through Product Sales**

**Presented by: Suman Ghosh, Florida Atlantic University** (Kameshwari Shankar; City College, City Univ of New York (CUNY))

In recent years, there has been a significant move by firms towards greater "Corporate Social Responsibility" (CSR). A common form of CSR employed by firms is to contribute a percentage of their profits towards a social good. Our model explores the potential for a market for such linked goods when purchase of the linked good allows the consumer to exhibit her altruism. We show that when such markets exist, the amount of the public good provided is lower than in the case of direct contributions. When the population consists of altruistic as well as non-altruistic consumers, then there is a possibility that firms earn higher profits as well the amount of public good contributions increase in the linked good case.

### **Targeted Advertising and Social Status**

**Presented by: Nick Vikander, Tinbergen Institute - Erasmus University Rotterdam**

This paper provides a novel reason why a firm may use non-targeted advertising. Consumers value social status, which depends on what other consumers believe about their wealth. Advertising transmits information allowing consumers to buy the good, but also to recognize it when others buy it. In equilibrium, the firm uses non-targeted advertising to promote conspicuous consumption. It sells to wealthy consumers but also advertises to poorer consumers who will not buy. Doing so ensures they understand what the goods signals, increasing the willingness to pay of those who buy. Trade may decrease social welfare, and in particular tends to make poorer consumers worse off. The mechanism shows effects often associated with persuasive advertising may instead result from informative advertising.

### **Bilateral monopoly in telecommunications: bargaining over fixed-to-mobile termination rates**

**Presented by: Tommaso Majer, Universidad Autonoma de Barcelona**

Mobile network operators are monopolists when they set the termination rate for the calls made to their own network. This is the main rationale under the regulatory activity in most European countries. Indeed, if left unregulated, fixed-to-mobile termination rates would be set too high, mainly because of two reasons: first, the mobile-to-fixed termination rates are usually regulated at cost, and second the fixed network operator has the obligation to terminate the incoming calls. So it can neither threaten to raise the mobile-to-fixed termination charge, nor to refuse to terminate the call. We propose a policy to overcome this termination bottleneck imposing reciprocity between the mobile-to-fixed and fixed-to-mobile termination rates. In the model we setup different negotiations over the termination rates.

### **Loss Leading as an exploitative practice**

**Presented by: Zhijun Chen, University of East Anglia** (Patrick Rey, Toulouse School of Economics)

Loss Leading pricing is often referred to as an advertising strategy which allows retailers to attract consumers by subsidizing some products and make profits from other items; in this way, below-cost pricing may improve consumer welfare by compensating consumers for their lack of information. This paper shows that large retailers can instead use loss leading as an exploitative device at the detriment of smaller retailers, without any efficiency justification in terms of distribution cost or advertising. We show further that banning below-cost pricing can unambiguously increase consumer surplus and social welfare as well as smaller retailers' profit.

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## **Session 59: Issues in Labour markets and Firms**

**Session Chair: Jin-Hyuk Kim, University of Cambridge**

**Room: 03 MS 01**

**Date: March 31, 2010**

**Time: 13:30 - 15:00**

### **Productivity, R&D Spillovers and Educational Attainment**

**Presented by: Vania Sena, Aston University** (Dolores Anon Higon; Universidad de Valencia)

Economists have long agreed that the local availability of more qualified workforce generates significant spillovers. This paper suggests that these externalities may arise because firms, having access to a more qualified workforce at a regional level, can benefit more from R&D spillovers than establishments located in areas with less qualified workforce. This hypothesis is tested on a sample of British establishments drawn from the Annual Business Inquiry (ABI) over the period 1997-2002. The main results are consistent with our expectations that the regional differences in the industry-level educational attainment of the workforce available to a plant will condition its capability of absorbing R&D spillovers.

### **Productivity, Capital and Labor in Labor-Managed and Conventional Firms**

**Presented by: Virginie Perotin, Leeds University Business School** (Fathi Fakhfakh, Paris 2 University and Monica Gago, Mondragon University)

The paper compares the productivity of labor-managed and conventional firms using two new panel data sets covering several thousand firms from France, including representative samples of conventional firms and all worker cooperatives with 20 employees or more in manufacturing and services. We present GLS and GMM estimations of translog production functions industry by industry for cooperative and conventional firms and allow systematic differences in scale and technology to be determined by the ownership form. The translog specification, which allows returns to scale to vary with input levels, makes it possible to disentangle embodied incentive effects from systematic differences in scale due to underinvestment in labor-managed firms. We also propose updated “stylized facts” about labor-managed firms in comparison with conventional firms.

### **Hiring Costs of Skilled Workers and the Supply of Firm-Provided Training**

**Presented by: Samuel Muehleemann, University of Bern** (Marc Blatter, University of Bern; Samuel Schenker, University of Bern and Stefan C. Wolter, University of Bern, CESifo & IZA Bonn)

This paper analyzes the effects of hiring costs for skilled workers on the firm’s supply of training positions. Much of the empirical evidence on labor adjustment costs points towards a convex relationship between hiring costs and the number of hires. Therefore, internal training of young unskilled workers might be an attractive alternative for firms to reduce the share of external hiring. Our results provide evidence that some firms indeed find it profitable to invest in costly training in order to reduce total hiring costs of skilled workers.

### **Share Bargaining and Joint Production**

**Presented by: Jin-Hyuk Kim, University of Cambridge**

Shares are often negotiated in partnership formation. When the agents bargain and produce sequentially, heterogeneous agents may fail to agree on a cooperative action, and the outcome may not be constrained efficient among the class of linear sharing rules. The agents may also fail to work as a team. This paper provides sufficient conditions for positive results, in which the agent heterogeneity vanishes in the limit.

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## **Session 60: Inequality: Measurement and Implications**

**Session Chair: Ajit Mishra, University of Bath**

**Room: AP 1**

**Date: March 31, 2010**

**Time: 13:30 - 15:00**

### **Estimates of Intergenerational Elasticities Based on Lifetime Earnings**

**Presented by: Oivind Anti Nilsen, Norwegian School of Economics and Business** (Kjell Vaage University of Bergen; Arild Aakvik University of Bergen and Karl Jacobsen; Statistics Norway)

Using Norwegian intergenerational data with a substantial part of the life-cycle earnings of children and almost the entire life-cycle earnings for their fathers, we present new estimates of intergenerational mobility. Extending the length of the fathers' earnings windows from 5 to 30 years increases the estimated elasticities. Increasing the age of father at observation has the opposite effect. Our findings indicate that intergenerational earnings mobility may have been strongly overstated in many earlier studies with shorter earnings histories. Biases in the estimated elasticities appear to be related to age and/or life-cycle measurement errors more than persistency in the transitory innovations.

### **Dealing with incomplete household panel data in inequality research**

**Presented by: Markus Grabka, DIW Berlin/ SOEP** (Joachim R. Frick; DIW Berlin/SOEP and Olaf Groh-Samberg; University of Bremen/SOEP)

This paper deals with the treatment of partial unit-non response (PUNR) in household panel studies, i.e. unit-nonresponse of at least one member of a household, and its impact on income inequality and mobility. While this phenomenon is of increasing relevance in surveys around the world, the aggregation of income across all household members in those cases falls just short of at least one individual's income. These processes are typically not at random, thus analyses and derived policy recommendation are subject to bias. Using data from the German Socio-Economic Panel Study (SOEP) we evaluate four different strategies: (a) Ignorance, i.e., assuming the missing individual's income to be Zero, (b) Adjustment of the equivalence scale, (c) Re-weighting procedures, (d) Longitudinal Imputation.

### **Accounting for changes in inequality: Decomposition analyses for Great Britain, 1968-2007**

**Presented by: Liam Wren-Lewis, University of Oxford** (Mike Brewer; Institute for Fiscal Studies and Alastair Muriel; Institute for Fiscal Studies)

This article analyses UK income and earnings inequality over the period 1968-2007 using various decomposition methodologies. We focus on changes in the income distribution since 1988. Decomposing inequality changes by both income source and individual characteristics, we are able to explain a significant amount of the changes in inequality over the last two decades. Notably, we find that whilst income from employment has continued to become less equal since the 1980s, this has not been the case for income derived from other sources such as investment and self-employment income. Furthermore, analysing changes in inequality over three periods of recession allows us to conclude that these periods of economic upheaval have had significant, but very different, effects on income inequality.

### **On Measuring Vulnerability to Poverty**

**Presented by: Ajit Mishra, University of Bath** (Indranil Dutta; University of Manchester and James Foster; George Washington University)

The paper proposes a conceptual framework and a measure of vulnerability to poverty. We highlight the importance of current standard of living in capturing the notion of vulnerability. In conceptualizing the new class of measures of vulnerability we thus move beyond the standard expected poverty measures. We axiomatically characterize the new set of measures and discuss some of their properties.

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## **Session 61: Aspects of Crime**

**Session Chair: Anandi Mani, The University of Warwick**

**Room: 32 MS 03**

**Date: March 31, 2010**

**Time: 13:30 - 15:00**

### **What Determines the Financial Gains to a Bank Robbery? Some Evidence for Great Britain**

**Presented by: Robert Witt, University of Surrey** (Barry Reilly, University of Sussex and Neil Rickman, University of Surrey)

This study uses bank-level data to model factors that determine the proceeds from a bank robbery. The econometric evidence reported suggests an important role for the number of bank raiders and the use of a firearm. The presence of a fast-rising security screen is found to exert the strongest attenuating effect on the financial rewards to bank robbery activity. Our analysis suggests that most of the impact of this security device is through its reduction in the probability that a raid is successful. Our preferred econometric estimates suggest that the installation of such a system in retail banking outlets reduces the probability of a successful raid by about one-half relative to the sample average.

### **Political Representation and Crime: Evidence from India's Panchayati Raj**

**Presented by: Anandi Mani, The University of Warwick** (Prachi Mishra, IMF; Lakshmi Iyer, Harvard Business School and Petia Topalova, IMF)

We examine the impact of political representation for women on crimes against them, using data from a decentralization initiative in India. We exploit variation in the timing of the implementation of this initiative across states to identify the impact. We find that having female leaders in local government induces a large and significant increase in reported crimes against women. There is no significant effect on crimes against men or gender-neutral crimes. The effects are not significant for crimes where under-reporting is not a serious concern. Overall, our results show that having female leaders at the local level lends a strong voice to women, resulting in a sharp increase in the reporting of crimes against them.



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## **Session 62: Political Economy and Social Choice**

**Session Chair: Michele Lombardi, University of Surrey**

**Room: AP 2**

**Date: March 31, 2010**

**Time: 13:30 - 15:00**

### **Ethnic Diversity and Local Conflicts**

**Presented by: Arcangelo Dimico, University of Nottingham** (Michael Bleaney, University of Nottingham)

We hypothesise that, given the typically uneven distribution of ethnic groups within a country, ethnic diversity leads to greater local polarization and more frequent, but smaller, conflicts that involve only some ethnic groups. These conflicts can be overlooked if the number of fatalities is small. Our empirical work exploits data on the proportion of a country affected by a conflict. We show that, ethnic diversity makes conflict more probable, but also makes it more likely to be localized. This finding is robust to persistence in the incidence and extent of conflict. This potentially explains the apparent lack of correlation between ethnic fractionalization and the incidence of conflict found in previous research that uses a higher threshold number of fatalities.

### **Private Information and Institutional Change: The Case of Foreign Threats**

**Presented by: Jing-Yuan CHIOU, IMT Lucca** (Mark Dincecco; IMT Lucca Institute for Advanced Studies and David Rahman; University of Minnesota)

We develop a theory that relates national security to political regimes, based on an autocratic ruler's private information about foreign threats. To convince the citizenry to yield high resources for defense, the ruler can implement limited government, which reduces rent expropriation in peacetime. However, institutional change will not occur when expected threat levels are high or low. For high threats, the ruler exploits citizen fears and transfers high rents without compromising security. For low threats, limited government decreases the ruler's ability to extract peacetime rents, without rendering sufficient benefit through improved defense during the (unlikely) event of attack. Our results explain the survival of real-world autocracies as sworn enemies (e.g., Myanmar) or prized allies (e.g., the Congo) of Western nations.

### **Moral Judgments in Social Dilemmas: How Bad is Free Riding?**

**Presented by: Michalis Drouvelis, University of York** (Robin P. Cubitt; University of Nottingham; Simon Gächter, University of Nottingham, CESifo and IZA and Ruslan Kabalin, University of Nottingham)

In the last thirty years economists and other social scientists investigated people's normative views on principles of distributive justice. Here we study people's normative views in social dilemmas, which underlie many situations of economic and social significance. Using insights from moral philosophy and psychology we provide an analysis of the morality of free riding. We use experimental survey methods to investigate people's moral judgments empirically. We vary others' contributions, the framing ("give-some" vs. "take-some") and whether contributions are simultaneous or sequential. We find that moral judgments depend strongly on others' behaviour; and that failing to give is condemned more strongly than withdrawing all support.

### **Liberal Egalitarianism and the Harm Principle**

**Presented by: Michele Lombardi, University of Surrey** (Roberto Veneziani, Queen Mary University of London)

This paper analyses Rawls's celebrated difference principle, and its lexicographic extension, in societies with a finite and an infinite number of agents. A unified framework of analysis is set up, which allows one to characterise Rawlsian egalitarian principles by means of a weaker version of a new axiom - the Harm Principle - recently proposed in the literature. This is quite surprising, because the Harm principle is meant to capture a liberal requirement of noninterference and it incorporates no obvious egalitarian content. A set of new characterisations of the maximin and of its lexicographic refinement are derived, including in the intergenerational context with an infinite number of agents.

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## **Session 63: Money, Credit and Crisis**

**Session Chair: Marcus Miller, University of Warwick**

**Room: 33 MS 03**

**Date: March 31, 2010**

**Time: 13:30 - 15:00**

### **Lending Relationship and Monetary Policy**

**Presented by: Henrique Basso, Uppsala University** (Yunus Aksoy, Birbeck, University of London and Javier Coto-Martinez, Brunel University)

We present a simple framework that introduces lending relationships, a relevant feature of financial intermediation that has been so far neglected in the monetary economics literature, into a DSGE model with staggered prices. Our main findings are: (i) banking spreads move countercyclically generating amplified output responses, (ii) spread movements are important for monetary policy even when a standard Taylor rule is employed (iii) modifying the policy rule to include a banking spread adjustment improves stabilization of shocks and increases welfare when compared to rules that only respond to output gap and inflation, and finally (iv) the presence of strong lending relationships in the banking sector can lead to indeterminacy of equilibrium forcing the central bank to react to spread movements.

### **Stabilizing an Unstable Economy: On the Choice of Proper Policy Measures**

**Presented by: Peter Flaschel, Bielefeld University** (Tarik Mouakil, University of Cambridge; Christian Proano, Macroeconomic Policy Institute, Düsseldorf and Willi Semmler, New School University, New York)

In this paper we focus on financial markets in a Keynesian business cycle model. We use a Tobin kind macroeconomic portfolio approach, and the interaction of heterogeneous agents on real and financial markets to characterize the potentials for financial market instabilities. Though the study of the latter has been undertaken in many partial models, we focus here on the interconnectness of all three markets. Furthermore, we study what potentials labor market, fiscal and monetary policies can have in stabilizing unstable macroeconomies. Beside other stabilizing policies we in particular propose a countercyclical monetary policy that sells assets in the boom and purchases assets in recessions. Modern stability analysis is brought to bear to demonstrate the stabilizing effects of those suggested policies.

### **Low Interest Rates and Housing Booms: Capital Inflows, Monetary Policy, and the Effects of Financial Innovation**

**Presented by: Pascal Towbin, IHEID** (Filipa Sa University of Cambridge and Tomasz Wieladek, Bank of England)

This study looks at the effects of monetary policy and capital inflows shocks on the housing market. We estimate a Panel VAR for a sample of OECD countries and identify shocks using sign restrictions. Both types of shocks are found to have a significant positive effect on house prices, private credit, and residential investment. To investigate how these effects change with the structure of the mortgage market and the degree of securitization, we augment the VAR to let the coefficients vary with mortgage market characteristics. Our results show a stronger response of housing variables to both types of shocks in countries with more developed mortgage markets. The amplification effect of securitization is particularly strong for capital inflows shocks.

### **Liquidity Constraints and Non-market Clearing: A Recipe for Recession?**

**Presented by: Marcus Miller, University of Warwick** (John Driffill, Birkbeck University of London)

In their 'workhorse model of money and liquidity', Kiyotaki and Moore (2008) show how a tightening of credit constraints can cut current investment and future aggregate supply. Despite these fluctuations in investment, however, aggregate demand matches current supply via a flex-price 'Pigou effect' that changes the value of real balances and so consumption. By switching from a flex-price to a fix-price characterisation of goods and labour markets, we find that demand failure can emerge after a liquidity shock. This extension of the KM framework offers an alternative 'workhorse' macro-model to that of Michael Woodford: it is in fact an updated version of Bernanke and Blinder (1988).

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## **Session 64: Performance of the Euro Area**

**Session Chair: Denise Osborn, University of Manchester**

**Room: 72 MS 03**

**Date: March 31, 2010**

**Time: 13:30 - 15:00**

### **Business Cycle Synchronization Across the Euro Area: a Wavelet Analysis**

**Presented by: Luis Aguiar-Conraria, NIPE, Universidade do Minho** (Maria Joana Soares, University of Minho)

We use wavelet analysis to study business cycle synchronization across the Euro12 Area. Based on the wavelet transform, we propose a metric to measure and test for business cycles synchronization. France and Germany form the core of the Euro-land, being the most synchronized countries with the rest of Europe. Portugal, Greece and Finland are in the Euro-periphery. We show that some countries have a French accent, while others have a German accent. For example, while Austria is highly synchronized with Germany, Spain looks a lot like France. Finally, we find that the French business cycle has been leading the German business cycle as well as the rest of Europe.

### **Interest rate convergence in the EMS prior to European Monetary Union**

**Presented by: Michael Froemmel, Ghent University** (Robinson Kruse, Aarhus University)

In this paper we analyze the convergence of interest rates in the European Monetary System (EMS) in a framework of changing persistence. This allows us to estimate the exact date of full convergence from the data. Due to the specific historical situation in the EMS the interest rate differential was non-stationary before the full convergence of interest rates was achieved and stationary afterwards. Our empirical results suggest different convergence dates for Belgium, France, the Netherlands and Italy. They are in line with the conclusions from a narrative approach and stress the importance of credibility for monetary policy.

### **The Euro Cash Changeover, Inflation Perceptions and the Media**

**Presented by: Michael Lamla, ETH Zurich** (Sara Lein, Swiss National Bank)

In the aftermath of the euro cash changeover, inflation perceptions rapidly rose while actual inflation figures remained almost unchanged. While several explanation have been already proposed this paper explores another important link: media reporting became unusually intensive and thereby influenced consumers' perceptions. Employing a unique dataset on media reporting for Germany, we provide evidence that the content of media reporting significantly contributed to the break-up of this relationship.

### **Modelling international linkages for large open economies: US and Euro Area**

**Presented by: Denise Osborn, University of Manchester** (Mardi Dungey, University of Tasmania)

Empirical modelling of Euro Area/US linkages requires an open economy specification. This paper proposes and implements a structural VECM framework that distinguishes between permanent and temporary shocks in a system with one cross-economy cointegrating relationship linking output levels. In addition, the short run dynamics incorporate both contemporaneous interactions and feedbacks between the two economies. Importantly, empirical coherence requires direct cross-country inflation spillover effects to apply. Estimated using data from 1983Q1 to 2007Q4, the results demonstrate the cross-country impacts of shocks. Although US shocks generally produce stronger effects, nevertheless some shocks originating in the Euro Area have significant effects on the US, particularly for inflation and interest rates.

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## **Session 65: Economic Theory II**

**Session Chair: Sonali Sen Gupta, University of Birmingham**

**Room: 39 MS 02**

**Date: March 31, 2010**

**Time: 13:30 - 15:00**

### **A Computational Theory of Exchange: Willingness to Pay, Willingness to Accept and the Endowment Effect**

**Presented by: Pete Lunn, Economic and Social Research Institute** (Mary Lunn, University of Oxford)

We present a theory of exchange that provides an alternative explanation for the endowment effect. Unlike standard neoclassical theories and Prospect Theory, our approach is not based on preference shape, but on adaptive responses to the problem of exchange when value is uncertain. We combine assumptions from perceptual and economic theory into a highly generalised model. Agents who maximise surplus but perceive uncertainty in the value of goods, will set willingness to accept (WTA) above willingness to pay (WTP). The disparity increases with the perceived uncertainty of value. We show also how feedback experienced over repeated exchanges may have heuristic value in learning to set optimal WTA and WTP. Our model receives some support from empirical studies of exchange.

### **The bargaining set in strategic market games**

**Presented by: Nicholas Ziros, University of Cyprus**

We present the bargaining set of an economy, where trades among groups of individuals are conducted via the Shapley-Shubik mechanism. Then we prove that in atomless economies the allocations resulting from this equilibrium notion are competitive.

### **Consumer Theory with Bounded Rational Preferences**

**Presented by: Georgios Gerasimou, University of Cambridge**

This paper studies preference representation and consumer demand when neither of the core rationality axioms of completeness and transitivity is in force. With appropriate generalizations and application of Shafer's (1974) theory, and assuming that preferences are strictly convex and "adaptive" in the sense that for any two incomparable alternatives some convex combination of them is weakly preferred to both, the existence of a demand function that satisfies the Weak Axiom of Revealed Preference is proved. Thus, in sharp contrast to the standard consumer who completely (pre)orders the alternatives and weighs when indifferent in order to make a single choice the proposed consumer weighs twice, both when indifferent and when indecisive. The additional assumption of quasi-transitivity leads to a demand function that also satisfies the Strong Axiom of Revealed Preference.

### **Correlated Equilibrium in Environmental Games**

**Presented by: Sonali Sen Gupta, University of Birmingham** (Indrajit Ray, University of Birmingham)

We consider correlation in the global emission game. We show that like Cournot-oligopoly game, the Nash equilibrium of this game is the only correlated equilibrium with continuous support (for a specific range of parameters). However, the Nash equilibrium can be improved upon by a mediated equilibrium with discrete support. Also, Nash equilibrium can be improved upon by weak correlation (for a specific range of parameters).

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## **Session 66: Modelling Health Reform, Demographics and Consumption**

**Session Chair: Zhigang Feng, University of Zurich**

**Room: 75 MS 02**

**Date: March 31, 2010**

**Time: 13:30 - 15:00**

### **Alternative Estimates of the Effect of the Increase of Life Expectancy on Economic Growth**

**Presented by: Muhammad Husain, Keele University**

The notion of a positive, significant, and sizable influence of life expectancy on economic growth has been challenged by Acemoglu and Johnson (2007). They found no evidence that the large increase in life expectancy led to a significant increase in per capita income. This paper takes up the modelling and estimation framework presented in Acemoglu and Johnson (2007), and presents alternative estimates on the impact of life expectancy on population, GDP, and GDP per capita by using alternative instruments, timeline, and country groups. The findings suggest that the pessimistic conclusion about the impact of life expectancy on income per capita requires caution; and that the increase of life expectancy may have had a positive impact on income per capita growth.

### **Fertility and mortality changes in an overlapping-generations model with realistic demography**

**Presented by: Sau-Him Lau, University of Hong Kong**

To examine the economic consequences of population changes, we incorporate more realistic demographic features in an overlapping-generations model with childhood, working and retirement stages. We also link fertility and mortality changes to, respectively, changes in total fertility rate and life expectancy, both of which are independent of the age composition of the population. We find that an increase in fertility and a reduction in mortality, while both causing a rise in the population growth rate, lead to opposite effects on capital accumulation. To provide intuition of these results, we decompose the impact of a demographic change into capital dilution and aggregate saving effects. For an endogenous change in aggregate saving, we further decompose it into individual saving and age-structure effects.

### **Household Consumption Behaviour: a cross-country comparison for Italy and the UK.**

**Presented by: Caterina Marini, University of Bari**

This paper provides a comprehensive cross-country comparison of consumption behaviour in Italy and the UK over the period 1970-2007. Traditionally, this type of studies gives partial and biased description of household spending habits because based on individual/few divisions of commodities. This paper provides a detailed assessment of the phenomenon by considering simultaneously all the first twelve divisions of the COICOP through two broad levels of analysis. An analytic description of the key patterns of country consumption behaviour provides a full qualitative assessment of cross-country differences and similarities. An empirical evaluation of the phenomenon through the Indirect Translog System shows significant results in terms of elasticity, and recognises consumption habits, income and relative price differentials as main factors influencing consumer behaviour.

### **Macroeconomic Consequences of Alternative Reforms to the Health Insurance System in the U.S.**

**Presented by: Zhigang Feng, University of Zurich**

This paper examines the macroeconomic and welfare implications of alternative U.S. health insurance systems taking the tax system as given. To do so, this paper considers a stochastic OLG framework with heterogeneous agents facing uncertain health shocks. Individuals make optimal labor supply, health insurance, and medical usage decisions. Since buying insurance is endogenous, this environment captures how different reforms affect the characteristics of the insured and the resulting health insurance premiums. The model is calibrated to U.S. data. Numerical simulations indicate that reforming the health insurance system has a quantitatively relevant impact on the number of uninsured, hours worked, and welfare.

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## **Session 67: Finance and Development Issues**

**Session Chair: David Fielding, University of Otago**

**Room: 80 MS 02**

**Date: March 31, 2010**

**Time: 13:30 - 15:00**

### **Medieval Microcredit?**

**Presented by: Mark Koyama, Brown University**

How do credit markets function in societies where legal contract enforcement is weak? This paper uses a theoretical model to examine how the institution of personal pledging aided the development of credit markets in medieval England. It demonstrates how the practice of pledging improved repayment rates by lowering enforcement costs and mitigating the problems associated with adverse selection. By combining the model with historical evidence, it can be shown that pledging helped to enable illiterate peasants to gain access to capital markets.

### **Uncertainty, Entrepreneurship and the Organisation of Corruption**

**Presented by: Yuanyuan Wang, University of Manchester** (Keith Blackburn, University of Manchester)

We develop a model of occupational choice in which private agents have the option of either working in some costless, but low-yielding, activity (subsistence production), or undertaking a costly, but potentially more rewarding, venture (entrepreneurship). We show how corruption has different effects depending on the way that it is practised: in the case of disorganised corruption, bribe payments are uncertain and capital market imperfections are allowed to surface; in the case of organised corruption, both of these features are removed. This result may be used to explain the puzzle of why corruption appears to be much less damaging in some countries than in others.

### **Moroccan company law reform and manufacturing firms' access to bank credit: A before/after panel evaluation**

**Presented by: Simon Quinn, University of Oxford**

In 2001, Morocco made a radical change to its company law regime: it replaced a company law dating from 19th-century France with modern standards of corporate governance and accountability. This paper analyses that reform and evaluates its impact upon manufacturing firms' access to bank credit. I use panel data from 2000 and 2004 to test the effect upon bank overdraft provision of a firm's legal obligations (that is, the firm's choice of SA status rather than the less onerous SARL). I find that the reform induced a substantial share of SA firms to switch to SARL, and that this caused a significant and substantial negative effect upon provision of bank overdraft facilities.

### **Information, Institutions and Banking Sector Development in West Africa**

**Presented by: David Fielding, University of Otago** (Panicos Demetriades, University of Leicester)

Using a new panel dataset for banks in eight West African countries, we explore the factors that determine banks' loans to assets ratios and the level of bank assets. Loan default rates in the region are high and are found to reduce both the loans to assets ratio and the volume of assets. However, the size of the effects is sensitive to bank age and ownership structure, with younger, private, domestically owned banks being most affected. This suggests that such banks face the most severe informational disadvantages. Improvements in the quality of governance are found to increase the loans to assets ratio and to promote asset growth.

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## **Session 68: Investment in Durables and Fixed Assets**

**Session Chair: John Tsoukalas, University of Nottingham**

**Room: 81 MS 02**

**Date: March 31, 2010**

**Time: 13:30 - 15:00**

### **From Consumer Incomes to Car Ages: How the Distribution of Income Affects the Distribution of Vehicle Vintages**

**Presented by: Anna Yurko, State University - Higher School of Economics**

This paper studies the relationship between consumer incomes and ages of the durable goods consumed. At the household level, it presents evidence from the CES of a negative correlation between incomes and ages of the vehicles owned. At the aggregate level, it constructs a dynamic, heterogeneous agents model to study the relationship between the distribution of consumer incomes and the distribution of vehicle vintages. The model's parameters are calibrated to match vehicle ownership data for the US in 2001. The moments of the income distribution are varied to generate predictions for mean and median ages of vehicles.

### **How Costly is Capital Adjustment? Empirical Evidence from a Structural Estimation**

**Presented by: Guiying Wu, Nanyang Technological University**

This paper presents estimates of the effects of capital adjustment costs on both short run investment behavior and long run capital accumulation for a panel of Brazilian manufacturing firms. The structural investment model features production technology, demand schedule, stochastic process characterizing uncertainty, and different forms of adjustment costs: irreversibility, a fixed cost of undertaking any investment at all, and quadratic adjustment costs. Structural parameters are estimated using Method of Simulated Moments. Counterfactual simulations indicate that investment would be much more responsive to new information about demand; and substantially higher capital stock would be accumulated, if firms in Brazil faced a lower level of adjustment costs. These effects are mainly due to a significant quadratic adjustment cost estimated from the sample.

### **Bank Lending, Durable Goods and Spreads**

**Presented by: Aqib Aslam, University of Cambridge** (Emiliano Santoro, University of Copenhagen)

The distributional effects of financial frictions on borrowers are investigated by introducing a monopolistically competitive banking sector in to a model of heterogeneous agents, durable goods and collateral constraints. These interest rate-setting banks interact with binding collateral constraints to produce a constant markup between interest rates in the steady state. These spreads increase the borrower's marginal rate of substitution (MRS) between durable and non-durable goods, as well as their MRS relative to the patient saver. We find that borrowers suffer proportionately more following a monetary policy tightening as their accumulation of durable goods falls, alongside a drop in non-durable goods consumption. The increased substitution away from durables feeds forward to future time periods by increasingly constraining borrowing opportunities going forward.

### **Investment Shocks and the Comovement Problem**

**Presented by: John Tsoukalas, University of Nottingham**

Recent work based on sticky price-wage estimated dynamic stochastic general equilibrium (DSGE) models suggests investment shocks are the most important drivers of US business cycles. Consumption, however, typically falls after an investment shock. We show that this problem is resolved in an estimated DSGE model when the cost of capital utilization is specified in terms of increased depreciation of capital. The alternative specification we consider has two additional implications relative to the traditional one: (i) it has a substantially better fit with the data and (ii) the contribution of investment shocks to the variance of consumption is over 3 times larger. Our work suggests that these shocks may be quantitatively even more important than previous estimates.

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## **Session 69: Monetary Economics and Policy**

**Session Chair: Carlo Strub, University of St. Gallen**

**Room: 01 AC 01**

**Date: March 31, 2010**

**Time: 13:30 - 15:00**

### **Seigniorage and distortionary taxation in a model with heterogeneous agents and uninsurable idiosyncratic uncertainty**

**Presented by: Sofia Bauducco, Central Bank of Chile**

We study optimal monetary and fiscal policy when agents are subject to idiosyncratic uninsurable shocks to labor productivity. We identify two main effects of anticipated inflation absent in representative agent frameworks. First, inflation stimulates savings for precautionary reasons, which translates into higher wages and lower taxes on labor income. This benefits poor, less productive agents. Second, inflation is a regressive consumption tax, which favors rich and productive agents. We calibrate our model to the U.S. and compute the optimal policy mix. We find that the Friedman rule is optimal. Aggregate welfare costs of inflation are small, but individual costs and benefits are large. Net winners from inflation are poor, less productive agents. Middle-class and rich households are net losers.

### **Commitment vs Discretion: An Empirical Investigation of the Monetary and Fiscal Policy Regime in the UK**

**Presented by: Stephanus le Roux, Department for Work and Pensions** (Tatiana Kirsanova, University of Exeter)

This paper investigates the conduct of monetary and fiscal policy in the UK. Using a simple DSGE New Keynesian model of policy interactions, we demonstrate that the past policy in the UK is better explained as following optimal policy under commitment rather than under discretion. We show and discuss the differences between the two policies and also estimate policy objectives. We find a significant weight on instrument smoothing but no evidence of debt targeting, and weak, if any, deficit targeting.

### **Money Cycles**

**Presented by: Carlo Strub, University of St. Gallen** (Andrew Clausen; University of Pennsylvania)

This paper presents a general equilibrium model where money is essential and agents exchange in competitive markets. A fixed cost of production induces them to take vacations during some periods. Hence, money is saved to purchase consumption during vacations. We show that agents will choose to acquire and spend money in cycles of finite length, even though aggregates are stationary. At any given time, agents have different positions on the money cycle. Throughout the money cycle, agents decrease their consumption and decrease their sensitivity to the inflation tax. This explains why some sellers accept money even though everybody wants to escape the old paradox.



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## **Session 70: Charitable Giving**

**Session Chair: Sarah Smith, CMPO, University of Bristol**

**Room: 02 AC 01**

**Date: March 31, 2010**

**Time: 13:30 - 15:00**

### **Payment Choice, Image Motivation and Contributions to Charity: Evidence from a Field Experiment**

**Presented by: Adriaan Soetevent, University of Amsterdam**

This paper examines the impact of payment choice on charitable giving with a door-to-door fund-raising field experiment. Respondents can donate cash only, use debit only, or have both options. Cash donations are anonymous whereas debit card donations are observed by the solicitor. When debit replaces cash, participation drops by 87 percent. Especially the number of donations smaller than 5Euros decreases significantly. When both cash and debit can be used, almost all donors make anonymous cash donations; revenues and participation rates decrease compared to the Cash-only treatment. This suggests that most people's giving is image-motivated.

### **Crowding out Both Sides of the Philanthropy Market: Evidence from a Panel of Charities**

**Presented by: Abigail Payne, McMaster University (James Andreoni, University of California, San Diego)**

When the government gives a grant to a private charitable organization, do the donors to that organization give less? If they do, is it because the grants crowd out donors who feel they gave through taxes (classic crowd out), or is it because the grant crowds out the fund-raising of the charities who, after getting the grant, reduce efforts of fund-raising (fund-raising crowd out)? This is the first paper to separate these two effects. Using a panel of more than 8,000 charities, we find that crowding out is significant, at about 72 percent. This crowding out is due to reduced fund-raising.

### **Donor Responses to Tax Incentives for Charitable Giving: Match, Rebate, and Rational Inattention**

**Presented by: Sarah Smith, CMPO, University of Bristol (Kimberley Scharf, University of Warwick and CEPR)**

We report results of a survey-based study of hypothetical donor responses to different alternative methods of channelling tax relief to voluntary donations by individuals to charities – either as a tax rebate for the donor or as a matched payment to the receiving charity. Although fully rational donors should view these two methods of delivery as being equivalent, we find that, in line with earlier experimental evidence, gross donations respond significantly more to changes in the match than to changes in the rebate. We show that these findings cannot be readily explained in a standard model of rational giving choices that includes additional effects stemming from donations – such as administrative costs or differential warm-glow effects.