EIEF NEWSLETTER: SPRING 2013

EIEFNews

EINAUDI INSTITUTE FOR ECONOMICS AND FINANCE

In this issue:

Marco Pagano argues that finance ceases to be the "lifeblood" of the real economy and turns into a "toxin" when it grows past the funding needs of the real sector, and explores the role of politics and regulation in generating this excessive growth.

Luigi Guiso reports on the first year of activity of the AXA Chair in Household Finance and Insurance.

The "Bajola Parisani Chair in Economics, Finance and Institutions" has been awarded for one year to Hugo Hopenhayn.

Francesco Lippi got an Advanced Grant from the European Research Council.

Contents

President
Marco Pagano

Director
Daniele Terlizzese

EIEF
Via Sallustiana, 62
00187 Roma
Tel: +39-06-67 90 013,+39-06-67 97 105
www.eief.it

1. Finance: good or bad for the economy?
by Marco Pagano[1]

Students in economics at their first asset pricing class are typically presented with a picture of finance as an efficient allocation machine that puts capital to its best possible use and allows people to share all kinds of risks efficiently. When they walk out of their classroom, however, these same students need read no further than the front page of the *Financial Times* or the *Wall Street Journal* to see financial markets and intermediaries indicted as the culprits in an enormous misallocation of resources. The media also routinely describe banks and security markets as the sources of risk, not efficient devices for trading and sharing it.

Such contrasting attitudes towards financial markets have been present in the writings of economists for decades, both sides fighting for the hearts and minds of generations of students and colleagues. What makes the contrast more strident today is the increased visibility of finance and the enormous scale of the current crisis (though not even these are entirely novel features, looking back at the role of finance in the Great Depression).

The bright and dark sides of finance

Economists have long seen banks and securities markets as the source of the economy's lifeblood; or, more specifically, as essential prerequisites for economic growth. For instance, John Hicks in 1969 argued that the critical new ingredient that ignited growth in eighteenth-century England was capital market liquidity, not technical progress *per se*. The view that finance promotes growth is supported by a vast and empirically robust body of empirical work that canvassed country-level, industry-level and firm-level data, and analyzed several "quasi-natural experiments" offered by specific (and arguably exogenous) changes in banking regulation or stock market liberalizations.

However, more critical voices have been also raised among economists, at least since Keynes (1936), who warned that financial markets can produce inefficient investment decisions, in that they may encourage short-term speculation rather than sound investment choices based on firms' long-term prospects. In an often quoted passage, Keynes wrote: "If I am allowed to appropriate the term speculation for the activity of forecasting the psychology of the market, and the term enterprise for the activity of forecasting the prospective yield of assets over their whole life, it is by no means always the case that speculation predominates over enterprise. As the organization of investment markets improves, the risk of the predominance of speculation does however increase... It is usually agreed that casinos should, in the public interest, be inaccessible and expensive. And perhaps the same is true of Stock Exchanges" (pp. 158-9). Keynes' view was echoed by a platoon of later researchers, including Hyman Minsky, who argued in the 1960s and 1970s that credit markets are inherently prone to boom-bust cycles driven by the irrational expectations of bankers and investors, and Robert Shiller, who since the 1980s has argued that stock and housing prices are often propelled by fads, causing bubbles and crashes. The recurrent financial crises of recent decades, culminating in the subprime crisis in the U.S. and the euro-area debt crisis, have led an increasing number of economists to see that in some circumstances financial markets pose a severe threat to economic activity – generating massive misallocation of resources and bubble-driven expansions followed by drastic deleveraging and slumps.

Economists have generally ascribed this dysfunctional behavior of financial markets to one of two root causes. Some hold that bubbles and crashes depend on investors' being guided by irrational (or not wholly rational) beliefs. This "behavioral finance" school is essentially a derivation of the Keynes-Minsky-Shiller line of thought. Others argue that the problem has to do with the incentives to bankers, asset managers and investors resulting from their contractual relationships, and even more from misguided regulation and monetary policy. For instance, the excessive credit boom and deterioration of lending standards in the run-up to the recent crisis has been blamed on the rise of an unregulated shadow banking system via securitizations (Adrian and Shin, 2010, Greenwood and Scharfstein, 2012), on very lax monetary policy (Dell'Ariccia, Igan, and Laeven, 2012, Maddaloni e Peydrò, 2011, Jimenez, Ongena, Peydrò and Saurina, 2011, Acharya and Naqvi, 2013), and on the expectation of government bailouts (Fahri and Tirole, 2012). Of course, this thesis raises the question of why policy makers should choose policies that have such perverse incentive effects on the financial markets. That is, it carries implications for the political economy of financial regulation.

A synthesis: the dark side prevails when the financial sector gets "too large"

How to reconcile the volumes of evidence witnessing of the financial markets positive effect on growth and the allocation of investment with the many instances of their dysfunctional behavior? When and why finance may cease to be the "lifeblood" of the economy and turn into a "toxin"? My claim is that the metamorphosis will occur when finance gets "too large" in relation to the underlying economy.

In the initial phase of economic development, as in Britain during the industrial revolution and in many of today's developing countries, advances in the financial system typically benefit the real economic activity. In these periods, firms are often subject to binding financing constraints, so that removing institutional barriers to financial development makes external finance available and spurs real economic growth. For instance, reforms that improve the enforcement of credit contracts or allow the entry of better-managed banks will result in the growth of credit, output and employment. Such reforms are likely to be associated with better selection of borrowers, hence fewer insolvencies.

However, as the availability of external finance expands, the fraction of financially constrained firms decreases, so that additional improvements in access to finance produce decreasing increments to output and employment. Indeed, when firms are no longer financially constrained, further increases in credit are unwarranted. Yet at this point financial regulation or monetary policy may still induce banks to expand credit beyond the funding needs of solvent firms and households, possibly by creating the expectation that banks will be bailed out if they become insolvent. Beyond some critical credit/GDP ratio threshold, therefore, we should find that further increases in external financing produce no significant expansion of real economic activity but cause a deterioration in credit quality and possibly even systemic instability.

This idea of a non-linear relationship between financial development and real economic activity is consistent with the evidence. First, estimating regressions based on the approach of Rajan and Zingales (1998) on data from 1970 to 2003, one finds that the positive relationship between industry-level growth and indicators of financial development is entirely driven by observations for the non-OECD countries, where firms are more likely to be finance-constrained. In the subsample of OECD countries, instead, the estimates indicate that financial development does not spur growth in value added. The non-linearity of the relationship between financial development and economic growth is also supported by the evidence in Arcand, Berkes and Panizza (2012) and Ductor and Grechyna (2012).

Financial development also appears to have a non-linear effect on the solvency of banks and the stability of the banking system. As argued above, insofar as an expansion in lending simply relieves the financial constraints on solvent firms, it need not lead to deterioration in credit quality. But if banks are awash with liquidity, they are likely to end up extending loans to bad risks or underpricing credit risk. Indeed, by estimating a fixed-effect panel regression of the creditworthiness of banks (measured by their country-year average "Z-score") on credit/GDP for 166 countries from 1997 through 2010, one finds that banks' creditworthiness is negatively correlated with the credit/GDP ratio in the subsample of countries where this ratio exceeds 50%, while in the subsample of countries where it is below 50%, the correlation is not significantly different from zero. A similar non-linearity can be found in the relationship between private credit and systemic risk, as measured by the capital shortfall that banks are expected to incur in a financial crisis (as in Acharya, Engle and Richardson, 2012). In the entire sample, systemic risk is positively correlated with the credit/GDP ratio: a credit expansion is associated not only with less sound banks but also with a more unstable system. Again, however, the relationship is statistically significant only for the countries with high credit/GDP ratios.

Why has regulation failed to prevent the hypertrophy of finance?

This raises an obvious question: why should regulation ever let the dark side of financial development emerge rather than contain it within bounds that ensure positive benefits? In other words, what explains the regulatory failures that lead to the hypertrophy of finance, and to the implied costs in terms of deterioration of credit quality, bank insolvencies and systemic risk?

Many regulatory failures have been prompted by politics, whose role in planting the seeds of the recent crisis has not been sufficiently recognized. For instance, in the U.S., the political determination to support widespread homeownership induced government-sponsored agencies such as Fanny Mae, Freddie Mac and AIG to guarantee low-quality loans in the securitization process, which contributed enormously to the subprime mortgage boom and to the house price bubble. The same can be said of the 2001 decision by the Federal Deposit Insurance Corporation to lower – drastically, from 8% to 1.6% – the capital requirement on banks in respect of mortgage-backed securities and most private sector collateral debt obligations (compared with the 4% requirement against mortgage loans and lower-rated mortgage securities), as well as of the 2004 SEC decision to exempt investment banks from capital regulations and entrust their risk monitoring to their own internal risk models. These decisions provided a huge inducement for banks both to securitize their loans and to invest in high-rated asset-backed and mortgage-backed securities. Similarly, in Europe, the decision by the EU Commission to exploit the "carve-out option" of Basel II regarding prudential ratios on sovereign debt permitted the assignment of zero risk weight to all euro-area sovereign debt. This encouraged EU banks to buy euro-area government bonds, especially those featuring high yields and high risk. While this undoubtedly facilitated national Treasuries in placing risky public debt, it also certainly increased the riskiness of euro-area banks (Acharya and Steffen, 2012).

One of the most spectacular cases of the role of politics in the over-expansion of finance before the bursting of the subprime bubble was that of Iceland. Benediktsdottir, Danielsson and Zoega (2011) describe how politicians provided essential support to the incredible transformation of a tiny fishing and aluminum-producing economy into an international banking platform, just in time to be a protagonist in the debt expansion and asset price bubble of 2003-07 and the subsequent catastrophic collapse. They explain how politicians first privatized the banks by selling them to their cronies in business (who bought their stakes using funds borrowed from those very banks) and then together with these cronies dreamt up the plan to make Iceland an international financial marketplace. A crucial ingredient was the implicit sovereign support that the government gave to the banks' record borrowing in 2004-05, which enabled them to access cheap, abundant international funding. No less important was the politicians' failure to equip their fledgling financial center with adequate supervisory authorities: the banks dwarfed the agencies that supposedly supervised them.

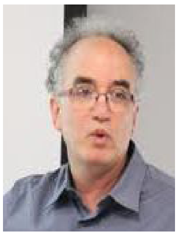
Another case in which regulators' failings were largely rooted in politics is that of Spain. The huge capital inflow into Spain prior to the crisis was mediated by a power bloc of managers of the savings banks (*cajas*), regional politicians and real estate developers, reciprocally supporting each other with favors and easy credit. They channeled massive amounts of credit into real estate, generating the housing bubble and substantial bad loans. Cuñat and Garicano (2009) show that the *cajas* whose chief executives had no banking experience and no graduate education but did have strong political connections extended more loans to real estate developers and fared substantially worse both before and during the crisis. The close connection between politicians and the bank managers was also a factor in the slow and ineffective response of Spanish prudential supervisors to the crisis, and the protracted forbearance on bad loans to developers. As Garicano (2012) puts it, "the main explanation for the supervisory failure of the Banco de España has to do with the political control of the *cajas* … [T]he supervisor, confronted with powerful and well-connected ex-politicians decided to look the other way in the face of obvious building trouble. Indeed the political connection of the managers of the entities was a good predictor of brewing trouble."

The experience of Iceland and Spain underscores another important point: namely, that credit-fuelled asset bubbles can easily produce broad political consensus, well beyond the circle of politicians and financiers. Once the bubble has started, the consensus tends to stretch throughout the population –a feature common to other countries as well in the run-up to the crisis. Most of society seems to profit from the bubble, not only bankers earning huge profits and bonuses, but also households reaping high returns on their assets and firms gaining from the boom in business – and of course politicians at the helm of governments basking in popularity. In 2008, Iceland ranked fourth in the world in per capita GDP!

What these patterns show is that politics is indeed a root cause of the hypertrophy of finance, and not just because of the capture of politicians by the banking lobby. The euphoria associated with the bubble creates vast political support, while the few who question its sustainability are seen as "spoil-sports" and "party-poopers", gadflies to be ignored – in the banks, in the political parties, and most likely even inside households. This is a point that applies to economy-wide bubbles very much in general. Once a bubble gets under way there is no constituency to stop it, because everyone simply tries to grab as much profit as possible as long as it lasts. The unfortunate implication is that the "dark side" of finance is entangled with a "dark side" of politics and society.

(1) This is a much abridged version of the paper "Finance: Economic Lifeblood or Toxin?", EIEF WP 2013/09, April 2013. Detailed references to the literature and to the estimates quoted here can be found in the paper. For published articles, the links here are to their working paper version.

2. New people at EIEF



Hugo Hopenhayn, who in the past visited EIEF on several occasions, has been awarded the "Bajola Parisani Chair in Economics, Finance and Institutions" for one year (he will be on leave from the University of California, Los Angeles). He studied economics at the University of Buenos Aires and got his Ph.D. at the University of Minnesota in 1988. He has taught at University Torcuato Di Tella, University of Rochester, Universitat Pompeu Fabra, Stanford University and University of Minnesota. He worked at the Federal Reserve Bank of Minneapolis and at the Fundaciòn de Investigationes Economicas Latinoamericanas (FIEL) in Buenos Aires.

Now he is the Director of the UCLA's Latin American Institute, Center for Argentina, Chile and the Southern Cone. He is also member of the National Bureau of Economic Research and of the American Economic Association, and associate editor of the Journal of Economic Theory. His main fields of interest are microeconomic theory, industrial organization, macroeconomics and labor economics. Hugo's research has made significant contributions to the theory of dynamic optimal contracting and of mechanism design, with important applications to patent design and the impact of financial frictions on firm dynamics.

During his stay at EIEF he will investigate in a novel way how the incentives for research and development (R&D) impact on innovation and economic progress. Most research in this area has focused on whether the patent system and other forms of intellectual protection might give firms incentives to under or over-invest in R&D. In contrast to this approach, the focus of Hugo's project will be on the direction of innovation, so that the key question to answer will be: does the private sector have incentives to invest in the "right" areas? The analysis will be both theoretical and empirical. On the theory side, a model of multiple R&D and innovation lines will be developed and solved for the socially optimal and equilibrium outcomes. On the empirical side, data on patenting will be used to compute the distribution of innovation according to these lines. The data will be also used to estimate the model and evaluate the appropriateness of different patent systems in directing innovation resources to the socially optimal outcomes.

Eleonora Patacchini joined EIEF's faculty last July as Research Affiliate, a new position created for young academics. Eleonora is Associate Professor in Economics and Statistics at the University of Rome "La Sapienza". She is also Research Fellow at the Kiel Institute for the World Economy and at IZA, and Research Affiliate at CEPR. Her main research interests focus on panel data econometrics, spatial statistics and graph theory, regional & urban economics, social and financial networks, ethnic minorities and immigrant integration patterns in Europe. She published several articles in distinguished international journals and, in 2011, she was awarded the "Oliver E. Williamson" Prize for the best article published in the Journal of Law, Economics and Organization:"Juvenile Deliquency and Conformism" (with Y. Zenou). Eleonora has been a regular visitor at EIEF for some years and has actively cooperated in the organization of seminars, conferences and in the Job Market selection procedure. Since 2010 she has also been involved in the teaching activities of EIEF's Graduate Program, giving a course on the Empirics of Networks.

3. The AXA Chair

The AXA Chair in Household Finance and Insurance, held by Luigi Guiso, started in January 2012. Its official launch, in the following March, with the participation of Ignazio Visco, Governor of the Bank of Italy, and Fréderic de Courtois, CEO of AXA MPS, received considerable attention from the Italian press.

In the first year, one important project undertaken by the Chair was the preparation of a review chapter on Household Finance for the new edition of the Handbook of Economics and Finance, edited by George Constantinides et al. (published by North Holland). A second relevant contribution was a study on the trading patterns of individual investors, and what triggers their sales and purchases of assets when trading is costly and people also face costs of gathering information about the value of their assets. The paper has been published in the American Economic Review.

The Chair has also been involved in setting up a new large-scale Household Finance project together with Luigi Pistaferri (Stanford University) and Andreas Fagereng (Statistics Norway). One of the key problems in empirical Household Finance is that household surveys have been and still are the main source of information for research. Surveys have the great advantage of collecting information on households' many features and choices, but they have serious disadvantages. The sample size is limited; it is difficult to collect data over many years for the same people and thus many surveys are just cross sections; when it comes to assets and incomes, measurement error is a serious concern as many households are unwilling to report they asset holdings and if they do they tend to underreport. To overcome these problems a novel dataset on Norwegian households, unique in many respects, is being created with the cooperation of the Norwegian national statistical institute. The dataset is based on administrative tax records that cover the whole Norwegian population and are available for a long time span (since 1995); as the data are reported to the tax authority directly by the intermediaries, not only they are error-free but they are also unlikely to be affected by tax evasion distortions. Once completed, this will be the most comprehensive database on household finance.

The Chair was also involved in two other relevant initiatives. First, an annual Household Finance conference, co-organized with other prominent centers worldwide. In 2012, EIEF, together with Oxford University, the National Bureau of Economic Research and Frankfurt University, organized a Household Finance Conference at Oxford. The next one will take place at EIEF in September 2013 (please, see the Call for papers). Second, a Household Finance network has been set up involving the best centers in Europe with an active group of researchers in the field. Besides EIEF, the network involves Oxford University Said School of Business, Stockholm University House of Finance, Frankfurt University and Aalto University (Helsinki).

4. A prestigious award

Francesco Lippi (Professor at the University of Sassari and Fellow at EIEF) has been awarded an European Research Council (ERC) 'Advanced Grant' for his research proposal :"The macroeconomic effects of microeconomic inaction". The Grant will finance a 5-year project that will involve both Italian and foreign researchers, with EIEF as host institution. Francesco is one of the 55 senior research leaders in Social Science Humanities selected this year in this prestigious competition, which involves researchers from 24 different countries across Europe. The funding allows the winners to pursue their most ground-breaking ideas at the frontiers of knowledge together with their own team.

Francesco's research has been focused for some years on the microfoundations of inertial behaviour by firms and/or households and on their effects on price/wage stickiness with a view to identify the implications as regards the persistence in the response of the aggregate economy to macro shocks. In this area, he already published a couple of articles on sticky prices (QJE, 2011) and sticky portfolios (AER, 2012).

As depending on modeling assumptions, the aggregate effects of stickiness range from being negligible to being substantial, the goal of the research funded by the ERC is twofold. The first purpose is to construct tractable macroeconomic models, based on individual behavior, that will yield substantial improvements in matching the patterns of the infrequent and heterogeneous adjustment recently documented in the micro data. In these structural models the micro evidence will serve as a selection/identification device for the proper modeling of the frictions faced by the agents. The second goal is to produce analytical tools to study the transmission of aggregate shocks (in money, interest rates, productivity, asset prices) in economies characterized by adjustment costs and cross-section heterogeneity. In particular, useful analytical methods will be developed to approximate the steady state behavior of an economy with stickiness, and to characterize the economy's response to aggregate shocks. Two recent EIEF working papers by Francesco, coauthored with Fernando Alvarez (University of Chicago) and Luigi Paciello (EIEF), both involved in the ERC project, begin to cast light on these topics: "Price Setting with Menu Cost for Multi-Product Firms" and "Monetary Shocks in a Model with Inattentive Producers".

The main focus of the research project will be on price stickiness, a core ingredient in a huge body of macroeconomic literature, because of its importance for policy analysis, and because of the wealth of micro data on price setting behavior. Furthermore applications will be developed in other areas where inertia, adjustment costs and heterogeneity are important, such as consumers' portfolio choices, durables' consumption, and the firm's capital investment decisions.

5. Conferences and other events

In 2012 EIEF hosted or organized, in co-operation with other institutions, several conferences and events. Some highlights are presented below, further information is available here or by clicking on the links below.

In April, EIEF hosted the second edition of the workshop on Structural Approaches to Productivity and Industrial Dynamics co-funded with CAED and IAB. Researchers in the field had the opportunity to discuss the most recent developments. Several issues were addressed, such as the role of demand and of TFP shocks in driving firm growth, the measurement of productivity in multi-product firms, the impact of research and development on quality and productivity. Among the presenters were: Ulrich Doraszeleski (University of. Pennsylvania), John Haltiwanger (University of Maryland), Andrea Pozzi (EIEF) and Mark Roberts (Pennsylvania State University).

Again, in April, EIEF hosted a conference on Economics of Interactions and Culture, jointly organized with the European Research Council, University of Rome "La Sapienza" and CEPR. The conference discussed recent research on the role of cultural traits, beliefs and social norms in a wide range of socio-economic interactions and in shaping the functioning of institutions and legal systems. Particular attention was devoted to the analysis of the transmission of religious beliefs and to the role of social capital in the cultural transmission of political values such as democracy. Among others, speakers were: Raquel Fernandez (New York University), Luigi Pistaferri (Stanford University and EIEF), Nancy Qian (Yale University) and Yves Zenou (Stockholm University).

In June, EIEF hosted and organized the first edition of the Rome Junior Conference on Macroeconomics. The spirit of this event is to bring together junior "high-fliers" macro economists from around the world, to discuss recent research in a friendly and very interactive environment. The conference was strictly by invitation. Several of the papers presented explored and analysed macro-financial issues related to the crisis.

Again, in June, EIEF hosted the 12th Doctoral Workshop in Economic Theory and Econometrics (MOOD 2012). This annual event is the result of the cooperation between three Italian research Institutions – the Bank of Italy, Collegio Carlo Alberto and EIEF - that are present on the international job market for young economists. Financial support was also provided by the Journal of Applied Econometrics and by the journal LABOUR. The presenters, all Ph.D. students who were expected to be on the 2013 job market, provided a broad overview of the arguments currently explored at the frontier of economic research. In turn, they received constructive feedbacks and criticisms, useful at the work-in-progress stage of their research, from the highly qualified attendance, including visiting scholars of international reputation.

In September EIEF hosted the conference New Developments in Econometrics and Time Series organized by the Collaborative Research Center 823 "Statistical modelling of nonlinear dynamic processes" and ECARES. Leaders in econometrics and time series analysis had the opportunity to discuss, exchange ideas and lay the basis for future collaborations. The main topics covered were: robust methods, volatility processes, factor models and estimation of covariance matrices. Among others, speakers were: Manfred Deistler (Vienna University of Technology), Søren Johansen (University of Copenhagen), Roger Koenker (University of Illinois) and Masanobu Taniguchi (Waseda University).

Again, in September, EIEF co-organized with NBER and CFS a conference on Household Finance, hosted by the University of Oxford (United Kingdom). Researchers from the U.S. and Europe discussed several issues related to the financial decisions taken by households as well as the actions of businessmen and government that may influence these decisions.

In December, EIEF hosted the second edition of the EIEF-UniBo Workshop in Industrial Organization, co-organized with the Bologna Centre for Law and Economics (BCLE) and the University of Bologna. The event strengthened the relationship between Italian economists working in the field, both in Italy and abroad. A limited number of papers were presented in plenary sessions to enhance discussion and interaction among participants.

Forthcoming Conferences and Workshops in 2013

On June 17-18, EIEF will host and organize the second edition of the Rome Junior Conference on Macroeconomics. The conference is strictly by invitation. Further information is available here.

On June 20, EIEF will host the fourth Carlo Giannini Ph.D. Workshop in Econometrics, organized with "Associazione Carlo Giannini". The submission deadline is April 21, 2013. For more details, see the Call for papers.

On July 1-3, EIEF will host the 13th Doctoral Workshop in Economic Theory and Econometrics, co-organized with the Bank of Italy and Collegio Carlo Alberto. Further information is available here.

The forum "Idee per la Crescita"

How to stimulate and ensure a sustainable growth in Italy? After almost two decades of languishing growth and four years of recession this has become a key question for Italy's future. Università Bocconi and EIEF launched the forum *Idee per la Crescita*, whose aim is to offer policy analysis and contributions to the formulation and implementation of a sustainable long-term growth strategy for Italy. The forum is directed by a Steering Committee, whose members are prominent academics and private sector operators. The forum plans to organize a series of evidence sessions, each one dedicated to a couple of specific topics that are thought to be particularly relevant for Italy's future.

Up to now, *Idee per la Crescita* has organized two meetings, both held at Università Bocconi. They focused on the optimal design of a school system, on how finance can facilitate innovation and on the causes of the decline of bank credit to firms and households during the current recession. The aim is to formulate some concrete proposals to reform radically the Italian school system, to alleviate the current "credit crunch" and to offer Italian firms new opportunities to finance innovation.

The results will be part of a first Report that *Idee per la Crescita* will launch in the Spring. More details will be available on the EIEF website.

Further information on the forum, the Steering Committee, goals and initiatives is available here.

6. Visitors

Winter 2012/Spring 2013

Simeon David Alder
University of Notre Dame

Fernando Alvarez
University of Chicago

Luca Anderlini
Georgetown University

Marco Battaglini
Princeton University

Daniele Checchi
Università Statale di Milano

Roberta Dessi
Toulouse School of Economics

Mikhail Golosov
MIT

Helios Herrera
Columbia University

Tullio Jappelli
Università di Napoli, Federico II

Keyu Jin
London School of Economics

Aubhik Khan
Ohio State University

Jan R. Magnus
Tilburg School of Economics and Management

Kiminori Matsuyama
Northwestern University

Guido Menzio
University of Pennsylvania

Massimo Morelli
Columbia University

Nancy Qian
Yale University

Howard Rosenthal
New York University

Esteban Rossi-Hansberg
Princeton University

Emiliano Santoro
Università Cattolica di Milano

Francesco Squintani
University of Warwick

Julia Thomas
Ohio State University

Matthew Turner
University of Toronto

Randy Wright
Wisconsin School of Business

Pierre Yared
Columbia University

William Zame
University of California, Los Angeles

Further information on 2013 Visiting Program is available here.

7. Lectures and Graduate Program

Summer Lectures

From mid June to mid July 2012 EIEF organized, for the second year in a row, a series of Summer Lectures, meant to provide a brief overview of recent pioneering research in four broad areas: Macroeconomics, Political Economy, Geography and Trade, Finance. In particular, among others the lectures covered topics such as "Productivity Losses from Financial Frictions" (Benjamin Moll), "Food Development, War and Famine" (Nancy Qian), "Random and Directed Search Models of the Labor Market" (Guido Menzio), "Facts and Models of International Relative Prices" (Ariel Burstein), "Natural Resources and Conflict" (Massimo Morelli), "Transport and Urban Form", (Vernon Henderson), "Regulatory Forbearance in the Financial Crisis" (Gur Huberman) (for the full list and related material see here). The Summer Lectures are one of the ways in which the intellectual resources attracted by EIEF are made available to a broader community of economists and policy makers. The audience mainly consisted of graduate students from various Italian Universities and of economists from the Bank of Italy, the Ministry of Economics and Finance and other Italian institutions and from commercial banks.

LABOUR Lectures

The 2012 LABOUR Lectures, organized by the scholarly Journal LABOUR: Review of Labour Economics and Industrial Relations were hosted in March by EIEF and given by Charles F. Manski (Northwestern University) who offered a broad overview on "Public Policy in an Uncertain World: Analysis and Decisions". More material is available here.
In June a second set of lectures was given by Joshua Angrist (MIT) and hosted by CEIS - University of Rome, "Tor Vergata".

Graduate Program

A broad description of EIEF Graduate Program was presented in the first issue of this Newsletter. The following, therefore, will only provide a quick update on the courses offered in the academic year 2012-13. The program started with review classes in Micro, Macro, Econometrics and Finance. These classes, held in September-October 2012, before the actual start of the regular courses, are mostly meant as a quick refresher on topics that should be largely familiar and as a self-assessment tool for students, helping them to identify those areas of their background training that need to be buttressed.

Following these review courses, in the Fall 2012, the topics covered were: Industrial Organization, Labor Economics, Empirical Macro, Corporate Finance, Asset Pricing, Latent Variables Models, Bayesian Econometrics and Nonparametric Methods.

The courses offered in the Spring 2013 include Behavioral Economics, Labor Market Institutions and Inequality, Economics of Networks, Consumption, Theory of Money, Topics in VAR Modeling, Econometrics of DSGE Models, Household Finance and Banking. Further information on these courses is available here.

8. Seminars

The following is a short list of forthcoming seminars

Economics

Philipp Kircher
University of Edinburgh
April 22

Edouard Challe
Ecole Polytecnique
April 29

Ignacio Palacios-Huerta
London School of Economics
May 6

Florin Bilbiie
Paris School of Economics
May 13

Econometrics

Ruben Durante
Science Po
April 18

Carlos Serrano
University of Toronto
May 2

Iourii Manovskii
University of Pennsylvania
May 9

Further information on past and forthcoming seminars is available here.

CONSOB-EIEF Seminars

In Spring 2012 CONSOB and EIEF launched a series of seminars on Financial Regulation. International experts in the field are invited to present papers on the various effects that changes in the regulation and in the accounting rules may have on the working of financial markets and institutions.

The audience mainly consisted of economists from CONSOB, the Ministry of Economics and Finance and from commercial banks, as well as of graduate students specialized in Finance.

Three seminars have already been organized and given by Andrew Ellul (Kelley School of Business, Indiana University), Patrick Bolton (Columbia University) and Ailsa Roell (School of International & Public Affairs, Columbia University). The papers are available here.

Other seminars are scheduled next May, June and July. Further information is available here.

9. Latest Working Papers

Highlights of some recent EIEF Working Papers are presented in the following. The full list is available here.

WP 2013/08

In "E-commerce as a Stockpiling Technology: Implications for Consumer Savings" Andrea Pozzi documents a previously neglected benefit of e-commerce. Since online orders are generally home delivered, shopping on the Internet spares customers the discomfort of carrying around heavy and bulky baskets of goods. This makes e-commerce a technology well suited to helping consumers to buy in bulk or to stockpile items on discount. Exploiting scanner data provided by a supermarket chain selling groceries both online and through traditional stores, the paper shows that the introduction of e-commerce leads to an increase of bulk purchases and stockpiling behavior by customers. Since bulk and discounted items are sold at a lower price per unit, this allows consumers to obtain substantial savings.

WP 2013/07

In "The Demand of Liquid Assets with Uncertain Lumpy Expenditures" Francesco Lippi, together with Fernando Alvarez, analyze how unexpected large-sized expenditures, such as the purchase of durable goods by households, impact on the management of liquid assets in the context of inventory theoretical models. The paper shows that lumpy purchases give rise to the possibility that liquidity gets withdrawn and spent immediately, thus changing the relationship between the size of liquidity withdrawals and the average liquidity holdings compared to canonical models. By using two novel datasets, the authors summarize the main patterns in the data concerning the households' currency management in Austria and the management of demand deposits by a large sample of Italian investors and show that their model can explain some empirical regularities that traditional models cannot account for.

WP 2013/06

Would citizens coordinate to punish a government when they observe suspicious behaviour? In "Coordination, Efficiency and Policy Discretion" Facundo Piguillem, together with Anderson Schneider, show that under some circumstances such coordination is impossible. The authors set up a model with incomplete information where the fundamental (aggregate productivity) is stochastic and observed only by the government, while every private agent receives a noisy signal about it. In this environment private agents cannot coordinate and punish the government when it deviates from optimal policies. The results of the paper support the arguments in favor of strong institutions that tie the hands of policymakers, as to endow governments with full discretion and to impose the right incentives to avoid deviation from optimal policies could be too costly.

WP 2013/05

In "Inequality and Relative Ability Beliefs" Jeffrey V. Butler documents a novel channel causing inequality persistence. In a sequence of experiments he shows that: i) individuals respond to salient (earnings) inequality by adjusting their performance beliefs to justify the inequality; ii) it is beliefs about relative ability – an ostensibly stable trait – rather than effort provision that are affected; and iii) unequal pay on an initial task affects willingness to compete on a subsequent task. Taken together, the results provide evidence for a novel mechanism perpetuating inequality: initial inequality colors beliefs about one's own ability relative to others, lowering the ex-ante expected return to courses of action which require, at some point, ability-based competition. As the latter is a feature of many paths to upward mobility, initial inequality may become persistent inequality.

10. Recently published papers

Forthcoming

"Second-Order Approximation of Dynamic Models with Time-Varying Risk", Pierpaolo Benigno (with Benigno, G., and S. Nisticò), **Journal of Economic Dynamics and Control**.

"The Role of Intuition and Reasoning in Driving Aversion to Risk and Ambiguity", Jeffrey V. Butler and Luigi Guiso (with T. Jappelli), **Theory and Decision**.

"The Determinants of Attitudes towards Strategic Default on Mortgages", Luigi Guiso (with Sapienza, P., and L. Zingales), **Journal of Finance**.

"Matching Firms, Managers and Incentives", Luigi Guiso (with Bandiera, O., Prat, A., and R. Sadun), **Journal of Labor Economics**.

"Pension Wealth Uncertainty", Luigi Guiso (with Jappelli, T., and M. Padula), **Journal of Risk and Uncertainty**.

"News, Noise, and Fluctuations: An Empirical Exploration", Jean-Paul L'Huillier (with Blanchard, O., and G. Lorenzoni), **American Economic Review**.

"The Demand of Liquid Assets with Uncertain Lumpy Expenditures", Francesco Lippi (with F. Alvarez), **Journal of Monetary Economics** (accepted with minor revisions).

"Exogenous Information, Endogenous Information and Optimal Monetary Policy", Luigi Paciello (with M. Wiederholt), **Review of Economic Studies**.

"The heterogeneous thresholds ordered response model: identification and inference", Franco Peracchi (with C. Rossetti), **Journal of the Royal Statistical Society - Series A**.

"E-commerce as a Stockpiling Technology: Implications for Consumer Savings", Andrea Pozzi, **International Journal of Industrial Organization**.

"The Effect of Internet Distribution on Brick-and-mortar Sales", Andrea Pozzi, **RAND Journal of Economics**.

"Does Idiosyncratic Business Risk Matter for Growth?", Fabiano Schivardi (with C. Michelacci), **Journal of the European Economic Association**.

"Competition Policy and Productivity Growth: An Empirical Assessment", Giancarlo Spagnolo (with Buccirossi, P., Ciari, L., Duso, T., and C. Vitale), **Review of Economics and Statistics**.

2013

"Credit within the Firm", Luigi Guiso, Luigi Pistaferri and Fabiano Schivardi, **Review of Economic Studies**, 2013, Volume 80, Issue 1, pages 211-247.

"Short-Selling Bans around the World: Evidence from 2007-09 Crisis", Marco Pagano (with A. Beber), **Journal of Finance**, 2013, Volume 68, Issue 1, pages 343-381.

"Heterogeneous Labor Skills, the Median Voter and Labor Taxes", Facundo Piguillem (with A. Schneider), **Review of Economic Dynamics**, 2013, Volume 16, Issue 2, pages 332-349.

2012

"International Portfolio Allocation under Model Uncertainty", Pierpaolo Benigno (with S. Nisticò), **American Economic Journal:**

Macroeconomics, 2012, Volume 4, Issue 1, pages 144-189.

"*Linear-Quadratic Approximation of Optimal Policy Problems*", Pierpaolo Benigno (with M. Woodford), **Journal of Economic Theory**, 2012, Volume 147, Issue 1, pages 1-42.

"*Risk, Monetary Policy and The Exchange Rate*", Pierpaolo Benigno (with Benigno, G., and S. Nisticò) in D. Acemoglu and M. Woodford, eds., **NBER Macroeconomics Annual 2011**, University of Chicago Press, 2012.

"*Durable Consumption and Asset Management with Transaction and Observation Costs*", Luigi Guiso and Francesco Lippi (with F. Alvarez), **American Economic Review**, 2012, Volume 102, Issue 5, pages 2272-2300.

"*The Market for Lawyers and Quality Layers in Legal Services*", Elisabetta Iossa (with B. Jullien), **RAND Journal of Economics**, 2012, Volume 43, Issue 4, pages 677-704.

"*Risk Allocation and the Costs and Benefits of Public – Private Partnership*", Elisabetta Iossa (with D. Martimort), **RAND Journal of Economics**, 2012, Volume 43, Issue 3, pages 442-474.

"*Vertical Integration and Costly Demand Information in Network Industries*", Elisabetta Iossa (with F. Stroffolini), **Review of Industrial Organization**, 2012, Volume 40, Issue 4, pages 249-271.

"*Did the U.S. Consumer Overreact? A Test of Rational Expectations*", Jean-Paul L'Huillier, **Economics Letters**, 2012, Volume 112, Issue 2, pages 207- 209.

Oil and the macroeconomy: A quantitative structural analysis", Francesco Lippi (with A. Nobili), **Journal of the European Economic Association**, 2012, Volume 10, Issue 5, pages 1059-1083.

"*Infinite-Dimensional Autoregressive Systems and the Generalized Dynamic Factor Model*", Marco Lippi, **Journal de la Société Française de Statistique**, 2012, Volume 153, Issue 1, pages 71-81.

"*Monetary Policy and Price Responsiveness to Aggregate Shocks under Rational Inattention*", Luigi Paciello, **Journal of Money, Credit and Banking**, 2012, Volume 44, Issue 7, pages 1375-1399.

"*Finance and Employment*", Marco Pagano (with G. Pica), **Economic Policy**, 2012, Volume 27, Issue 69, pages 5-55.

"*Corporate Fraud, Governance and Auditing*", Marco Pagano (with G. Immordino), **Review of Corporate Finance Studies**, 2012, Volume 1, Issue 1, pages 109-133.

"*Securitization, Transparency and Liquidity*", Marco Pagano (with P.Volpin), **Review of Financial Studies**, 2012, Volume 25, Issue 8, pages 2417-2453.

"*Juvenile Deliquency and Conformism*", Eleonora Patacchini (with Y. Zenou), **Journal of Law, Economics & Organization**, 2012, Volume 28, Issue 1, pages 1-31.

"*Ethnic Networks and Economic Outcomes*", Eleonora Patacchini (with Y. Zenou), **Regional Science & Urban Economics**, 2012, Volume 42, Issue 6, pages 938-949.

"Organized Crime Networks: an Application of Network Analysis Tecniques to the American Mafia", Eleonora Patacchini (with G. Mastrobuoni), **Review of Network Economics**, 2012, Volume 11, Issue 3, Article 10.

"Urban Crime and Ethnicity", Eleonora Patacchini (with Y. Zenou), **Review of Network Economics**, 2012, Volume 11, Issue 3, Article 11.

"Asymptotically Efficient Estimation of the Conditional Expected Shortfall", Franco Peracchi (with Leorato, S., and A.V. Tanase), **Computational Statistics and Data Analysis**, 2012, Volume 56, Issue 4, pages 768-784.

"Heterogeneity in health responses and anchoring vignettes", Franco Peracchi (with C. Rossetti), **Empirical Economics**, 2012, Volume 42, Issue 2, pages 513-538.

"Aging, cognitive abilities and retirement", Franco Peracchi (with F. Mazzonna), **European Economic Review**, 2012, Volume 56, Issue 4, pages 691-710.

"Estimating Engel curves under unit and item nonresponse", Franco Peracchi (with G. De Luca), **Journal of Applied Econometrics**, 2012, Volume 27, Issue 7, pages 1076-1099.

"A generalized missing-indicator approach to regression with imputed covariates", Franco Peracchi (with Dardanoni,V., and S. Modica), **Stata Journal**, 2012, Volume 12, Number 4, Article 2.

"Shopping Cost and Brand Exploration in Online Grocery", Andrea Pozzi, **American Economic Journal: Microeconomics**, 2012, Volume 4, Issue 3, pages 96-120.

"Reputation, competition, and entry in procurement", Giancarlo Spagnolo, **International Journal of Industrial Organization**, 2012, Volume 30, Issue 3, pages 291-296.

"Fines, Leniency and Rewards in Antitrust", Giancarlo Spagnolo (with Bigoni, M., Fridolfsson, S., and C. Le Coq), **RAND Journal of Economics**, 2012, Volume 43, Issue 2, pages 368-390.

"Commodity Money with Frequent Search", Nicholas Trachter (with E. Oberfield), **Journal of Economic Theory**, 2012, Volume 147, Issue 6, pages 2332-2356.

2011

"The Inflation-Output Trade-Off with Downward wage Rigidities", Pierpaolo Benigno (with L. Ricci), **American Economic Review**, 2011, Volume 101, Issue 4, pages 1436-1466.

"Inflation Differentials in a Currency Area: Facts, Explanation and Policy", Pierpaolo Benigno (with Altissimo, F., and D. Rodriguez Palenzuela), **Open Economic Review**, 2011, Volume 22, Issue 2, pages 189-233.

"Enhancing capabilities through credit access: Creditworthiness as a signal of trustworthiness under asymmetric information", Pierluigi Conzo (with L. Becchetti), **Journal of Public Economics**, 2011, Volume 95, Issue 3-4, pages 265-278.

"What Determines Entrepreneurial Clusters?", Luigi Guiso and Fabiano Schivardi, **Journal of the European Economic Association**,

2011, Volume 9, Issue 1, pages 61-86.

"*Crowding Out Intrinsic Motivation in the Public Sector*", Elisabetta Iossa (with Georgellis, Y., and V. Tabvuma), **Journal of Public Administration Research and Theory**, 2011, Volume 21, Issue 3, pages 473-493.

"*Optimal Price Setting with Observation and Menu Costs*", Francesco Lippi and Luigi Paciello (with F. Alvarez), **Quarterly Journal of Economics**, 2011, Volume 126, Issue 4, pages 1909-1960.

"*The general dynamic factor model: One-sided representation results*", Marco Lippi (with M. Forni), **Journal of Econometrics**, 2011, Volume 163, Issue 1, pages 23-28.

"*Does Inflation Adjust Faster to Aggregate Technology Shocks than to Monetary Policy Shocks*", Luigi Paciello, **Journal of Money, Credit and Banking**, 2011, Volume 43, Issue 8, pages 1663-1684.

"*Incentives to Innovate and Social Harm: Laissez-Faire, Authorization or Penalties?*", Marco Pagano (with Immordino, G., and M. Polo), **Journal of Public Economics**, 2011, Volume 95, Issue 7-8, pages 864-876.

"*Ethnic identity and labour-market outcomes of immigrants in Europe*", Eleonora Patacchini (with Bisin, A., Verdier, T., and Y. Zenou), **Economic Policy**, 2011, Volume 26, Issue 65, pages 57-92.

"*Formation and persistence of oppositional identities*", Eleonora Patacchini (with Bisin, A., Verdier, T., and Y. Zenou), **European Economic Review**, 2011, Volume 55, Issue 8, pages 1046-1071.

"*Neighborhood Effects and Parental Involvement in the Intergenerational Transmission of Education*", Eleonora Patacchini (with Y. Zenou), **Journal of Regional Science**, 2011, Volume 51, Issue 5, pages 987-1013.

"*Early-life environment, height and BMI of young men in Italy*", Franco Peracchi (with E. Arcaleni), **Economics and Human Biology**, 2011, Volume 9, Issue 3, pages 251-264.

"*Estimating Income Poverty in the Presence of Missing Data and Measurement Error*", Franco Peracchi (with Foliano, F., and C. Nicoletti), **Journal of Business and Economic Statistics**, 2011, Volume 29, Issue 1, pages 61-72.

"*Regression with imputed covariates: A generalized missing indicator approach*", Franco Peracchi (with Dardanoni, V., and S. Modica), **Journal of Econometrics**, 2011, Volume 162, Issue 2, pages 362-368.

"*Costly Financial Intermediation in Neoclassical Growth Theory*", Facundo Piguillem (with Mehra, R., and E. Prescott), **Quantitative Economics**, 2011, Volume 2, Issue 1, pages 1-36.

"*Asset Prices, Debt Constraints and Inefficiency*", Pietro Reichlin (with G. Bloise), **Journal of Economic Theory**, 2011, Volume 146, Issue 4, pages 1520-1546.

"*Entry Barriers in Italian Retail Trade*", Fabiano Schivardi (with E. Viviano), **Economic Journal**, 2011, Volume 121, Issue 551, pages 145-170.

"*Equilibrium Selection in the Repeated Prisoner's Dilemma: Axiomatic Approach and Experimental Evidence*", Giancarlo Spagnolo (with Blonski, M., and P. Ockenfels), **American**

Economic Journal: Microeconomics, 2011, Volume 3, Issue 3, pages 164-192.

"*Networks of relations and Word-of-Mouth Communication*", Giancarlo Spagnolo (with S. Lippert), **Games and Economic Behavior**, 2011, Volume 72, Issue 1, pages 202-217.

"*Measuring the Deterrence Properties of Competition Policy*", Giancarlo Spagnolo (with Buccirossi, P., Ciari, L., Duso, T., and C. Vitale), **Journal of Competition Law and Economics**, 2011, Volume 7, Issue 1, pages 165-204.

2010

"*The Structure of Multiple Credit Relationships: Evidence from U.S. firms*", Luigi Guiso (with R. Minetti), **Journal of Money, Credit and Banking**, 2010, Volume 42, Issue 6, pages 1037-1071.

"*Commercial Activity as Insurance: the Investment Behaviour of Non-Profit Organizations*", Elisabetta Iossa (with Bennet, J., and G. Legrenzi), **Annals of Public and Cooperative Economics**, 2010, Volume 81, Issue 3, pages 445-465.

"*Contracting out public service provision to not-for-profit firms*", Elisabetta Iossa (with J. Bennet), **Oxford Economic Papers**, 2010, Volume 62, Issue 4, pages 784-802.

"*Over-optimism and lender liability in the consumer credit market*", Elisabetta Iossa (with G. Palumbo), **Oxford Economic Papers**, 2010, Volume 62, Issue 2, pages 374-394.

"*New Eurocoin: Tracking Economic Growth in Real Time*", Marco Lippi (with Altissimo, F., Cristadoro, R., Forni, M., and G. Veronese), **The Review of Economics and Statistics**, 2010, Volume 92, Issue 4, pages 1024-1034.

"*Inheritance Law and Investment in Family Firms*", Marco Pagano (with Panunzi, F., and A. Ellul), **American Economic Review**, 2010, Volume 100, Issue 5, pages 2414-2450.

"*Credit Ratings Failures and Policy Options*", Marco Pagano (with P. Volpin), **Economic Policy**, 2010, Volume 25, Issue 62, pages 401-431.

"*How Does Liquidity Affect Government Bond Yiels?*", Marco Pagano (with Favero, C., and E. von Thadden), **Journal of Financial and Quantitative Analysis**, 2010, Volume 45, Issue 1, pages 107-134.

"*Legal Standards, Enforcement, and Corruption*", Marco Pagano (with G. Immordino), **Journal of the European Economic Association**, 2010, Volume 8, Issue 5, pages 1104-1132.

"*Tax buyouts*", Fabiano Schivardi (with Del Negro, M., and F. Perri), **Journal of Monetary Economics-Carnegie-Rochester Conference Series on Public Policy**, 2010, Volume 57, Issue 4, pages 576-595.

"*Asymmetry and Collusion in Sequential Procurement: A "Large Lot Last" Policy*", Giancarlo Spagnolo (with G. L. Albano), **The B.E. Journal of Theoretical Economics**, 2010, Volume 10, Issue 1 (Topics), Article 43.