
Literature Report

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Abstract

TESTING FOR MULTIPLE BUBBLES: HISTORICAL EPISODES OF EXUBERANCE AND COLLAPSE IN THE S&P 500

- International Economic Review---2015---Peter Phillips, Shuping Shi, Jun Yu

Recent work on econometric detection mechanisms has shown the effectiveness of recursive procedures in identifying and dating financial bubbles in real time. These procedures are useful as warning alerts in surveillance strategies conducted by central banks and fiscal regulators with real-time data. Use of these methods over long historical periods presents a more serious econometric challenge due to the complexity of the nonlinear structure and break mechanisms that are inherent in multiple-bubble phenomena within the same sample period. To meet this challenge, this article develops a new recursive flexible window method that is better suited for practical implementation with long historical time series. The method is a generalized version of the sup augmented Dickey–Fuller (ADF) test of Phillips et al. (“Explosive behavior in the 1990s NASDAQ: When did exuberance escalate asset values?” International Economic Review 52 (2011), 201–26; PWY) and delivers a consistent real-time date-stamping strategy for the origination and termination of multiple bubbles.

Simulations show that the test significantly improves discriminatory power and leads to distinct power gains when multiple bubbles occur. An empirical application of the methodology is conducted on S&P 500 stock market data over a long historical period from January 1871 to December 2010. The new approach successfully identifies the well-known historical episodes of exuberance and collapses over this period, whereas the strategy of PWY and a related cumulative sum (CUSUM) dating procedure locate far fewer episodes in the same sample range.

TESTING FOR MULTIPLE BUBBLES: LIMIT THEORY OF REAL-TIME DETECTORS

- International Economic Review---2015---Peter Phillips, Shuping Shi, Jun Yu

This article provides the limit theory of real-time dating algorithms for bubble detection that were suggested in Phillips, Wu, and Yu (PWY; International Economic Review 52 [2011], 201–26) and in a companion paper by the present authors (Phillips, Shi, and Yu, 2015; PSY; International Economic Review 56 [2015a], 1099–1134. Bubbles are modeled using mildly explosive bubble episodes that are embedded within longer periods where the data evolve as a stochastic trend, thereby capturing normal market behavior as well as exuberance and collapse. Both the PWY and PSY

estimates rely on recursive right-tailed unit root tests (each with a different recursive algorithm) that may be used in real time to locate the origination and collapse dates of bubbles. Under certain explicit conditions, the moving window detector of PSY is shown to be a consistent dating algorithm even in the presence of multiple bubbles. The other algorithms are consistent detectors for bubbles early in the sample and, under stronger conditions, for subsequent bubbles in some cases. These asymptotic results and accompanying simulations guide the practical implementation of the procedures. They indicate that the PSY moving window detector is more reliable than the PWY strategy, sequential application of the PWY procedure, and the CUSUM procedure.

FIRM DYNAMICS IN AN URBAN ECONOMY

- International Economic Review---2015---Jeffrey Brinkman,Daniele Coen-Pirani,Holger Sieg,Daniele Coen-Pirani

We develop a new dynamic general equilibrium model to explain firm entry, exit, and relocation decisions in an urban economy with multiple locations and agglomeration externalities. We characterize the stationary distribution of firms that arises in equilibrium. We estimate the parameters of the model using a method of moments estimator. Using unique panel data collected by Dun and Bradstreet, we find that agglomeration externalities increase the productivity of firms by up to 8%. Economic policies that subsidize firm relocations to the central business district increase agglomeration externalities in that area. They also increase economic welfare in the economy.

THE MORPHOLOGY OF PRICE DISPERSION

- International Economic Review---2015---Greg Kaplan,Guido Menzio

This article is a study of the shape and structure of the distribution of prices at which an identical good is sold in a given market and time period. We find that the typical price distribution is symmetric and leptokurtic, with a standard deviation between 19%

and 36%. Only 10% of the variance of prices is due to variation in the expensiveness of the stores at which a good is sold, whereas the remaining 90% is due, in approximately equal parts, to differences in the average price of a good across equally expensive stores and to differences in the price of a good across transactions at the same store. We show that the distribution of prices that households pay for the same bundle of goods is approximately Normal, with a standard deviation between 9% and 14%. Half of this dispersion is due to differences in the expensiveness of the stores where households shop, whereas the other half is mostly due to differences in households' choices of which goods to purchase at which stores. We find that households with fewer employed members pay lower prices and do so by visiting a larger number of stores instead of by shopping more frequently.

HIERARCHICAL ORGANIZATION AND PERFORMANCE INEQUALITY: EVIDENCE FROM PROFESSIONAL CYCLING

- International Economic Review---2015---Bertrand Candelon,Arnaud Dupuy

This article proposes an equilibrium theory of the organization of work in an economy with an implicit market for productive time. In this market, agents buy or sell productive time. This implicit market gives rise to the formation of teams, organized in hierarchies with one leader (buyer) at the top and helpers (sellers) below. Relative to autarky, hierarchical organization leads to higher within and between team payoffs/productivity inequality. This prediction is tested empirically in the context of professional road cycling. We show that 46% of performance inequality in the Tour de France is due to hierarchical organization within team whereas team composition only accounts for 6%.

THE TRANSMISSION MECHANISM IN GOOD AND BAD TIMES

- International Economic Review---2015---Haroon Mumtaz,Paolo Surico

Does the transmission of economic policies and structural shocks vary with the state of the economy? We answer this question using a strategy based on quantile regressions, which account for endogenous regressors and state-dependent parameters. An application to U.S. real activity and interest rate reveals pervasive asymmetries in the propagation mechanism across good and bad times. During periods when real activity is above its conditional average, the estimates of the degree of forward-lookingness and interest rate semi-elasticity are significantly larger (in absolute value) than the estimates associated with below-average periods. Results are robust to alternative strategies to model state-dependent parameters.

QUALITY CHOICE AND MARKET STRUCTURE: A DYNAMIC ANALYSIS OF NURSING HOME OLIGOPOLIES

- International Economic Review---2015---Haizhen Lin

This article develops a dynamic model of entry and exit to analyze quality choice and oligopoly market structure in the nursing home industry. I find significant heterogeneity in the competitive effects across market structures: Firms of similar quality levels compete more strongly than dissimilar firms. Sunken entry costs are extremely large, and quality adjustment behavior is governed by significant fixed adjustment costs. A proposal to eliminate low-quality nursing homes is found to cause a large supply-side shortage, and another proposal to lower entry costs has offered a perverse incentive to provide low quality of care.

QUANTIFYING THE IMPACTS OF LIMITED SUPPLY: THE CASE OF NURSING HOMES

- International Economic Review---2015---Andrew Ching,Fumiko Hayashi,Hui Wang

This article develops a new estimation method that accounts for excess demand and the unobserved component of product quality. We apply our method to study the Wisconsin nursing home market in 1999 and find that nearly 20% of elderly qualified for Medicaid were

rationed out. However, our counterfactual experiment shows that the net welfare gain of fulfilling all nursing home demands may be small, because the welfare gain could be largely offset by the increase in Medicaid expenditures. We also find that a 1% increase in quality would crowd out 3.2% Medicaid patients in binding nursing homes.

EXCHANGE RATE MANIPULATION AND CONSTRUCTIVE AMBIGUITY

- International Economic Review---2015---Ricardo Fernholz

I consider dynamic models in which investors are heterogeneously informed about both foreign exchange interventions and exchange rate fundamentals and show that transparency sometimes exacerbates misalignment between the exchange rate and fundamentals. Although transparency reveals information about fundamentals, it also increases the precision of the exchange rate as a signal of those fundamentals that remain unknown (the signal-precision effect of transparency). If a central bank announcement reveals little information about fundamentals, then this effect dominates and transparency magnifies misalignment. One implication is that ambiguity can increase the effectiveness of intervention to support a declining currency during times of crisis.

LEGISLATED PROTECTION AND THE WORLD TRADE ORGANIZATION

- International Economic Review---2015---T. Renee Bowen

Tariff bindings and administered protection are two characteristics of the World Trade Organization (WTO) that are little understood. Tariff bindings place a ceiling on tariffs that is not always reached, whereas administered protection provides all industries with some minimum import protection, effectively creating a floor for protection. How do these policies affect applied most favored nation (MFN) tariff rates that are enacted through the legislature? I model tariffs determined by a dynamic legislative process and show

that low applied MFN tariffs are less likely with tariff bindings and more likely with administered protection than under purely legislated protection.

MONEY TALKS? AN EXPERIMENTAL INVESTIGATION OF CHEAP TALK AND BURNED MONEY

- International Economic Review---2015---Thomas de Haan,Theo Offerman,Randolph Sloof

We experimentally study the strategic transmission of information in a setting where both cheap talk and money can be used. Theoretically, many equilibria exist side by side, in which senders use either costless messages, money, or both. We find that senders prefer to communicate through costless messages. Only when the interest disalignment between sender and receiver increases does cheap talk tend to break down and high sender types start burning money to enhance the credibility of their costless messages. A behavioral model assuming that sellers bear a cost of lying fits the data best.

CREDIT RATIONING, RISK AVERSION, AND INDUSTRIAL EVOLUTION IN DEVELOPING COUNTRIES

- International Economic Review---2015---Eric Bond,James Tybout,Hale Utar

Relative to their counterparts in high-income regions, entrepreneurs in developing countries face less efficient financial markets, more volatile macroeconomic conditions, and higher entry costs. This article develops a dynamic empirical model that links these features of the business environment to cross-firm productivity distributions, entrepreneurs' welfare, and patterns of industrial evolution. Fit to panel data on Colombian apparel producers, the model yields estimates of a credit market imperfection index, the sunk costs of creating a new business, and various technology parameters. Model-based counterfactual experiments suggest that improved intermediation could dramatically increase the return on assets for entrepreneurial households with modest wealth.

SWITCHING COST AND DEPOSIT DEMAND IN CHINA

- International Economic Review---2015---Chun-Yu Ho

This article develops and estimates a dynamic model of consumer demand for deposits in which banks provide differentiated products and product characteristics that evolve over time. The switching cost is 0.8% of the deposit's value, which leads the static model to bias the demand estimates. The dynamic model shows that the price elasticity over a long time horizon is larger than the same elasticity over a short time horizon. Counterfactual experiments with a dynamic monopoly show that reducing the switching cost has a comparable competitive effect on bank pricing as a result of reducing the dominant position of the monopoly.

OPTIMAL GRADING

- International Economic Review---2015---Robertas Zubrickas

The teacher-student relationship is modeled as an agency problem, where teachers are concerned with human capital formation and students with ability signaling. We distinguish between two cases depending on whether in ability inference the job market can or cannot observe the grading rule applied. We show that many empirical grading patterns, including grade compression and inflation, are all consistent with optimal ability screening when grading rules are unobservable. With observable grading rules, the teacher perfectly screens students' abilities, provided that certain conditions hold. We apply the model to discuss policy applications such as "No Child Left Behind."

ANTIDUMPING, INTRA-INDUSTRY TRADE, AND QUALITY REVERSALS

- International Economic Review---2015---José L. Moraga-González,Jean-Marie Viaene

We examine an export game where two (home and foreign) firms produce vertically differentiated products. The foreign firm is more R&D efficient and is based in a

larger and richer market. The unique (risk-dominant) Nash equilibrium exhibits intra-industry trade, and the foreign producer manufactures a higher-quality product. When transport costs are low, unilateral dumping by the foreign firm arises; otherwise, reciprocal dumping occurs. For some parameters, a domestic antidumping policy leads to a quality reversal in the international market whereby the home firm becomes the quality leader. This policy is desirable for the implementing country, though world welfare decreases.

TESTING MODELS OF DIFFERENTIATED PRODUCTS MARKETS: CONSOLIDATION IN THE CABLE TV INDUSTRY

- International Economic Review---2015---David P. Byrne

Research on differentiated products markets often uses structural demand/supply models to identify firms' marginal costs as product-level cost data are unavailable. Using unique demand and cost data from cable TV, I evaluate a differentiated products model's ability to identify marginal costs. I find firms systematically price below profit-maximizing levels, leading to biases in the model's marginal cost estimates. I study the implications for merger simulations and find that these biases compromise estimates of merger-related cost efficiencies, yet do not prevent these models from generating useful predictions of the price and nonprice effects of mergers.

SEQUENTIAL OR SIMULTANEOUS ELECTIONS? A WELFARE ANALYSIS

- International Economic Review---2015---Patrick Hummel,Brian Knight

Should all voters vote on the same day or should elections be staggered? Using a model of voting and social learning, we illustrate that sequential elections place too much weight on early states but also provide late voters with valuable information. Simultaneous elections equally weigh states but place too much weight on voter priors, providing an inappropriate advantage

to front-runners. Simultaneous elections are thus preferred if the front-runner advantage is small, but sequential elections are preferred if the advantage is large. Our quantitative welfare analysis of presidential primaries suggests that simultaneous systems slightly outperform sequential systems.

TRUST, VALUES, AND FALSE CONSENSUS

- International Economic Review---2015---Jeffrey Butler,Paola Giuliano,Luigi Guiso

Individuals' beliefs about the trustworthiness of a generic member of the population are both heterogeneous across individuals and persistent across generations. We investigate one mechanism yielding these dual patterns: false consensus. In the context of a trust game experiment, we show that the relationship between behavior and beliefs is consistent with individuals extrapolating their trust beliefs from their own trustworthiness and that this tendency continues even after substantial learning opportunities. We go on to provide evidence suggesting that one's own trustworthiness can be traced back to the values parents transmit to their children during their upbringing.

FRAMING OF INCENTIVES AND EFFORT PROVISION

- International Economic Review---2015---Olivier Armantier,Amadou Boly

A prospect theory model combining loss aversion and diminishing sensitivity predicts that the link between incentives framing and effort is ambiguous: small penalties yield higher effort, but isomorphic contracts with large penalties decrease effort. We conduct two experiments (a framed field and a conventional lab experiment) in which economically equivalent contracts are framed as menus of either (i) bonuses, (ii) penalties, or (iii) bonuses and penalties. The experimental results confirm the main intuition of the model as subjects performed best when bonuses and penalties are combined. A follow-up lottery experiment confirms that both loss aversion and diminishing sensitivity influenced the performance.

CONFORMISM AND STRUCTURAL CHANGE

- International Economic Review---2015---Takeo Hori,Masako Ikefuji,Kazuo Mino

Using a simple, multisector model of endogenous growth, we show that commodity-specific consumption externalities can be a source of structural change. When the degrees of consumption externalities are different between goods, each sector grows at a different rate. However, the aggregate economy exhibits balanced growth in that capital stock and expenditure grow at the same constant rate. A three-sector version of our model may reconcile Kaldor's stylized facts with empirically plausible profiles of industrial structure transformation.

REGULATION, IMPERFECT COMPETITION, AND THE U.S. ABORTION MARKET

- International Economic Review---2015---Andrew Beauchamp

The U.S. abortion market has grown increasingly concentrated recently, while many states tightened abortion laws. Using data on abortion providers, I estimate an equilibrium model of demand, price competition, entry and exit, to capture the effect of regulation on industry dynamics. Estimates show regulations played an important role in determining the abortion market structure and evolution. Counterfactual simulations reveal increases in demand-aimed regulation were the most important observed factor in explaining recent abortion declines. Simulating Utah's regulatory regime nationally shows tightening abortion restrictions can increase abortions in equilibrium, mainly through tilting the competitive landscape toward low-price providers.

INTERMEDIATED CORRUPTION

- International Economic Review---2015---Elton Dusha

I model the role of intermediaries in corruption and examine the effects of policy on the level of intermediated corruption, price of permits, and welfare. Intermediaries with a history of being honest earn higher

premiums. The frequency of corrupt transactions is inversely related to income levels. When the government increases the fraction of profits that it extracts from entrepreneurs, intermediation intensifies, as entrepreneurs are reluctant to obtain licenses through legal means. Therefore, when business costs are high, measures to combat corruption transfer value to intermediaries. Increasing the frequency of government audits can increase the equilibrium price of permits.

BARGAINING FAILURES AND MERGER POLICY

- International Economic Review---2015---Roberto Burguet,Ramon Caminal

We study approval rules in a model where horizontal merger proposals arise endogenously as the outcome of negotiations among the firms in the industry. We make two main points. First, relatively inefficient merger proposals succeed with positive probability. That is, the negotiation process may result in a particular merger agreement despite the existence of an alternative one that would generate higher profits and higher consumer surplus. Second, the antitrust authority should optimally commit to an approval rule that is more stringent for all mergers than the optimal ex post rule.

ESTIMATION OF DYNAMIC DISCRETE CHOICE MODELS BY MAXIMUM LIKELIHOOD AND THE SIMULATED METHOD OF MOMENTS

- International Economic Review---2015---Philipp Eisenhauer,James Heckman,Stefano Mosso

We compare the performance of maximum likelihood (ML) and simulated method of moments (SMM) estimators for dynamic discrete choice models. We construct and estimate a simplified dynamic structural model of education that captures some basic features of educational choices in the United States in the 1980s and early 1990s. We use estimates from our model to simulate a synthetic data set and assess the ability of ML and SMM to recover the model parameters on this sample. We investigate the performance of alternative tuning parameters for SMM.

LABOR MARKET SEARCH AND SCHOOLING INVESTMENT

- International Economic Review---2015---Christopher Flinn,Joseph Mullins

We generalize a search, matching, and bargaining model to allow individuals to acquire productivity-enhancing schooling prior to labor market entry. In general, search frictions and weakness in bargaining position contribute to underinvestment in schooling from an efficiency perspective. Using estimates of a general equilibrium version of the model in which firm vacancy creation decisions are included, we find that minimum wages and schooling subsidies improve aggregate welfare, but have very different welfare impacts across the ability distribution. In particular, policies that maximize the average welfare of workers have strongly negative effects on the welfare of the least able.

THE EFFECTS OF VOCATIONAL REHABILITATION FOR PEOPLE WITH COGNITIVE IMPAIRMENTS

- International Economic Review---2015---David Dean,John Pepper,Robert Schmidt,Steven Stern

This article utilizes administrative data to examine both short- and long-term employment impacts for people with cognitive impairments who applied for vocational rehabilitation services in Virginia in 2000. These data provide long-term quarterly information on services and employment outcomes. We model behavior, allow for multiple service choices, use long-run labor market data, and use valid instruments. Results imply that services generally have positive long-run labor market outcome effects that appear to substantially exceed the cost of providing services.

HOUSEHOLD INTERACTION AND THE LABOR SUPPLY OF MARRIED WOMEN

- International Economic Review---2015---Zvi Eckstein,Osna Lifshitz

Are changing social norms affecting the employment rates of women? A model is built in which the employment of husbands and wives is the outcome of potentially exogenously determined three different types of household games: the Classical household, where the spouses play a Stackelberg leader game in which the wife's labor supply decision is based on her husband's employment outcome; the Modern household, which is characterized by a symmetric and simultaneous game solved as a Nash equilibrium, and the Cooperative household, where the couple jointly maximizes the weighted sum of their utilities. In all models, husbands' employment is similar whereas wives work much less in Classical households.

THE HOME SELLING PROBLEM: THEORY AND EVIDENCE

- International Economic Review---2015---Antonio Merlo,François Ortalo-Magné,John Rust

We formulate and solve the problem of a homeowner who wants to sell her house for the maximum possible price net of transactions costs. We estimate this model using data on transaction histories for 780 residential properties in England. The estimated model fits list price dynamics and other key features of the data. In particular, a tiny menu cost of changing the listing price, as little as ten thousandths of 1% of the house value, is sufficient to explain the high degree of stickiness of listing prices observed in the data.

EFFECTS OF PERMANENT AND TRANSITORY TAX CHANGES IN A LIFE-CYCLE LABOR SUPPLY MODEL WITH HUMAN CAPITAL

- International Economic Review---2015---Michael Keane

I examine effects of labor income taxation in life-cycle models with human capital accumulation. In this case, the opportunity cost of time equals the wage plus returns to work experience. This has several interesting consequences: First, the data appear consistent with larger labor supply elasticities than prior work suggests. Second, contrary to conventional wisdom, permanent

tax changes can have larger effects on current labor supply than temporary changes. Third, human capital dampens responses of young workers to transitory tax changes. Fourth, labor supply elasticities increase with age. Fifth, human capital amplifies the effect of permanent tax changes in the long run.

INFLATION EXPECTATIONS AND BEHAVIOR: DO SURVEY RESPONDENTS ACT ON THEIR BELIEFS?

- International Economic Review---2015---Olivier Armantier,Wändi Bruine de Bruin,Giorgio Topa,Wilbert van der Klaauw,Basit Zafar

We compare the inflation expectations reported by consumers in a survey with their behavior in a financially incentivized investment experiment. The survey is found to be informative in the sense that the beliefs reported by the respondents are correlated with their choices in the experiment. More importantly, we find evidence that most respondents act on their inflation expectations showing patterns consistent with economic theory. Respondents whose behavior cannot be rationalized tend to have lower education and lower numeracy and financial literacy. These findings help confirm the relevance of inflation expectations surveys and provide support to the microfoundations of modern macroeconomic models.

DOES IT PAY FOR WOMEN TO VOLUNTEER?

- International Economic Review---2015---Robert Sauer

This article estimates the economic and noneconomic returns to volunteering for prime-aged women. Estimates of a DCDP model indicate that an extra year of volunteer experience increases wage offers by 8.5% in future part-time work and by 2.6% in future full-time work. On average, working for free increases lifetime earnings by 16.7%. The economic returns to volunteering are more important than the noneconomic returns in increasing lifetime utility. The model also reveals an adverse selection mechanism into volunteering that helps explain why reduced-form regressions of

the returns to working for free will likely be downward biased.

ESTIMATING DYNAMIC DISCRETE CHOICE MODELS WITH HYPERBOLIC DISCOUNTING, WITH AN APPLICATION TO MAMMOGRAPHY DECISIONS

- International Economic Review---2015---Hanming Fang,Yang Wang

We extend the semiparametric estimation method for dynamic discrete choice models using Hotz and Miller's (Review of Economic Studies 60 (1993), 497–529) conditional choice probability approach to the setting where individuals may have hyperbolic discounting time preferences and may be naive about their time inconsistency. We illustrate the proposed identification and estimation method with an empirical application of adult women's decisions to undertake mammography to evaluate the importance of present bias and naivety in the underutilization of this preventive health care. Our results show evidence for both present bias and naivety.

DIVORCE AND THE COGNITIVE ACHIEVEMENT OF CHILDREN

- International Economic Review---2015---Melissa Tartari

Children of divorced parents exhibit lower test scores and educational attainment. Have these correlations a causal interpretation? Parents who divorce may be less likely to invest in their children while together or they may divorce to shield their children from the effects of marital conflict. I study the relationship between children's achievement and the marital status of their parents within a dynamic framework in which partners decide on whether to remain married, how to interact (with or without conflict), and child investments. I then assess whether a child whose parents divorced would have been better off had divorce not occurred.

JOB MATCHING WITHIN AND ACROSS FIRMS

- International Economic Review---2015---Elena Pastorino

This article proposes a matching model of the labor market in the presence of uncertainty and learning about ability that provides a simple unified framework for analyzing the dynamics of jobs and wages within firms and in the labor market. The model allows for different degrees of generality of ability as well as speeds of learning across jobs and firms. Equilibrium assignments and wages are consistent with a broad range of empirical findings on careers, suggest a novel interpretation for well-documented patterns, and help explain features of careers usually thought difficult to reconcile with the presence of uncertainty and learning.

PENSION DESIGN WITH A LARGE INFORMAL LABOR MARKET: EVIDENCE FROM CHILE

- International Economic Review---2015---Clement Joubert

This article investigates the fiscal and welfare trade-offs involved in designing a pension system when workers can avoid contributing by working informally. Using a life-cycle model of labor supply and saving decisions, I structurally estimate preferences and earnings opportunities in the formal and informal sectors using data on Chilean households. I find limited support for formal jobs rationing. Instead, mandatory pension contributions significantly encourage informality. Policy experiments show that Chile could lower minimum pension spending by 23%—while guaranteeing the same income to retirees—if the minimum pension’s implicit tax rate was increased to 60%.

COLLATERAL REQUIREMENTS AND ASSET PRICES

- International Economic Review---2015---Johannes Brumm,Michael Grill,Felix Kubler,Karl Schmedders

Many assets derive their value not only from future cash flows but also from their ability to serve as collateral.

In this article, we investigate this collateral premium and its impact on asset returns in an infinite-horizon general equilibrium model with heterogeneous agents. We document that borrowing against collateral substantially increases the return volatility of long-lived assets. Moreover, otherwise identical assets with different degrees of collateralizability exhibit substantially different return dynamics because their prices contain a sizable collateral premium that varies over time. This premium can be positive even for assets that never pay dividends.

TECHNOLOGICAL LEARNING AND LABOR MARKET DYNAMICS

- International Economic Review---2015---Martin Gervais,Nir Jaimovich,Henry Siu,Yaniv Yedid-Levi,Yaniv Yedid-Levi

The search-and-matching model of the labor market fails to match two important business cycle facts: (i) a high volatility of unemployment relative to labor productivity, and (ii) a mild correlation between these two variables. We address these shortcomings by focusing on technological learning-by-doing: the notion that it takes workers’ time using a technology before reaching their full productive potential with it. We consider a novel source of business cycles, namely, fluctuations in the speed of technological learning, and show that a search-and-matching model featuring such shocks can account for both facts. Moreover, our model provides a new interpretation of recently discussed “news shocks.”

RECURSIVE AMBIGUITY AND MACHINA’S EXAMPLES

- International Economic Review---2015---David Dillenberger,Uzi Segal

Machina (American Economic Review 99 (2009), 385–392; American Economic Review 104 (2014), 3814–40) lists a number of situations where Choquet expected utility, as well as other known models of ambiguity aversion, cannot capture plausible features of ambiguity attitudes. Most of these problems arise in

choice over prospects involving three or more outcomes. We show that the recursive nonexpected utility model of Segal (International Economic Review 28 (1987), 175–202) is rich enough to accommodate all these situations and, moreover, that this can be done using the same functional form for all situations.

DYNAMIC WAGE AND EMPLOYMENT EFFECTS OF ELDER PARENT CARE

- International Economic Review---2015---Meghan Skira

This article formulates and estimates a dynamic discrete choice model of elder parent care and work to analyze how caregiving affects a woman's current and future labor force participation and wages. The model incorporates parental health changes, human capital accumulation, and job offer availability. The estimates indicate that women face low probabilities of returning to work or increasing work hours after a caregiving spell. I use the estimated model to simulate the caregiving, employment, and welfare effects of a longer unpaid work leave than currently available under the Family and Medical Leave Act, a paid leave, and a caregiver allowance.

SHARED PATENT RIGHTS AND TECHNOLOGICAL PROGRESS

- International Economic Review---2015---Matthew Mitchell,Yuzhe Zhang

We study how to reward innovators who build on one another. Rewards come in the form of patents. Because patent rights are scarce, the optimal allocation involves sharing: More than one innovator's patent is in force at a given time. We interpret such allocations as patents that infringe one another as licensing through an ever growing patent pool and as randomization through litigation. We contrast the rate of technological progress under the optimal allocation with the outcome if sharing is prohibitively costly. Avoiding sharing initially slows progress and leads to a more variable rate of technological progress.

COMPETITION POLICY AND CARTEL SIZE

- International Economic Review---2015---Iwan Bos,Joseph E. Harrington

This article examines endogenous cartel formation in the presence of a competition authority. Competition policy is shown to make the most inclusive stable cartels less inclusive. In particular, small firms that might have been cartel members in the absence of a competition authority are no longer members. Regarding the least inclusive stable cartels, competition policy can either decrease or increase their size and, in the latter case, the collusive price can rise.

A DYNAMIC MODEL OF CLEANUP: ESTIMATING SUNK COSTS IN OIL AND GAS PRODUCTION

- International Economic Review---2015---Lucija Muehlenbachs

The environmental remediation required to permanently decommission most industrial projects is an expensive, irreversible investment. Real options literature shows that temporary closure has value under uncertainty. However, even if there is no intention to restart operations, there is an incentive to label a closure as “temporary” to avoid having to remediate ongoing or future environmental externalities. I estimate a dynamic discrete choice model of closure under price and quantity uncertainty to evaluate the likelihood of reactivation. The model reveals that the option to temporarily close is being widely used to avoid environmental remediation of oil and gas wells in Canada.

EFFECTS OF INDEX-FUND INVESTING ON COMMODITY FUTURES PRICES

- International Economic Review---2015---James Hamilton,Jing Cynthia Wu

We develop a simple model of futures arbitrage that implies that if purchases by commodity index funds influence futures prices, then the notional positions of the index investors should help predict excess returns in these contracts. We find no evidence that the positions

of index traders in agricultural contracts as identified by the Commodity Futures Trading Commission can help predict returns on the near futures contracts. Although there is some support that these positions might help predict changes in oil futures prices over 2006–2009, the relation breaks down out of sample.

MALE AND FEMALE MARRIAGE RETURNS TO SCHOOLING

- International Economic Review---2015---Gustaf Bruze

A collective marriage matching model is estimated and calibrated to quantify the share of returns to schooling that is realized through marriage. The predictions of the model are matched with detailed Danish household data on the relationship between schooling and wage rates, the division of time and goods within the household, and the extent to which men and women sort positively on several traits in marriage. Counterfactual analysis conducted with the model suggests that Danish men and women are earning on the order of half of their returns to schooling through improved marital outcomes.

STRUCTURAL HOMOPHILY

- International Economic Review---2015---Vincent Boucher

Homophily, or the fact that similar individuals tend to interact with each other, is a prominent feature of economic and social networks. I show that the equilibrium structure of homophily has empirical power. I build a strategic model of network formation, which produces a unique equilibrium network. Individuals have homophilic preferences and face capacity constraints on the number of links. I develop a novel empirical method, based on the shape of the equilibrium network, which allows for the identification and estimation of the underlying homophilic preferences. I apply this new methodology to the formation of friendship networks.

A HYBRID DISCRETE CHOICE MODEL OF DIFFERENTIATED PRODUCT DEMAND WITH AN APPLICATION TO PERSONAL COMPUTERS

- International Economic Review---2015---Minjae Song

In this article, I consider a new discrete choice model of differentiated product demand that distinguishes a brand-level differentiation from a product-level differentiation. The model is a hybrid of the random coefficient logit model of Berry et al. (Econometrica 63 (1995), 841–90) and the pure characteristics model of Berry and Pakes (International Economic Review 48 (2007), 1193–1225) and describes markets where firms offer multiple products of different qualities under the same brand name. I compare the hybrid model with existing models using data on personal computers. Using the estimates of the hybrid model, I also provide empirical evidence that firms reposition their brands in a postmerger market.

LONG-RUN VERSUS SHORT-RUN PERSPECTIVES ON CONSUMER SCHEDULING: EVIDENCE FROM A REVEALED-PREFERENCE EXPERIMENT AMONG PEAK-HOUR ROAD COMMUTERS

- International Economic Review---2015---Stefanie Peer,Erik Verhoef,Jasper Knockaert,Paul Koster,Yin-Yen Tseng

Earlier studies on scheduling behavior have mostly ignored that consumers have more flexibility to adjust their schedule in the long run than in the short run. We introduce the distinction between long-run choices of travel routines and short-run choices of departure times, using data from a real-life peak avoidance experiment. We find that participants value travel time higher in the long-run context, supposedly because changes in travel time can be exploited better through the adjustment of routines. Schedule delays are valued higher in the short run, reflecting that scheduling restrictions are typically more binding in the short run.

MODELING MOVEMENTS IN INDIVIDUAL CONSUMPTION: A TIME-SERIES ANALYSIS OF GROUPED DATA

- International Economic Review---2014---Orazio Attanasio,Margherita Borella

We characterize the time-series properties of group-level consumption, income, and interest rates using microdata. We relate the coefficients of moving average representations to structural parameters of theoretical models of consumption behavior. Using long time series of cross sections to construct synthetic panel data for the United Kingdom, we find that for high-educated individuals the Euler equation restrictions are not rejected, the elasticity of intertemporal substitution is higher than one, and there is evidence of “excess smoothness” of consumption. Low-educated individuals, conversely, exhibit excess sensitivity of consumption to past income, and the elasticity of intertemporal substitution is not statistically different from zero.

GLOBALIZATION AND MULTIPRODUCT FIRMS

- International Economic Review---2014---Volker Nocke,Stephen Yeaple

We present an international trade model with multi-product firms. Firms are heterogeneously endowed with two types of capabilities that jointly determine the trade-off within firms between managing a large portfolio of products and producing at low marginal cost. The model can explain many of the documented cross-sectional correlations in firm performance measures, including why larger firms are more productive and more diversified, and yet more diversified firms trade at a discount. Globalization is shown to induce heterogeneous responses across firms in terms of scope and productivity, some of which are consistent with existing empirical work, whereas others are potentially testable.

PRIVATE PROVISION OF PUBLIC GOODS AND INFORMATION DIFFUSION IN SOCIAL GROUPS

- International Economic Review---2014---Kimberley Scharf

I describe a dynamic model of costly information sharing where private information affecting collective-value actions is transmitted by social proximity. Individuals make voluntary contributions toward the provision of a pure public good, and information transmission about quality of provision is a necessary condition for collective provision to take place in a stationary equilibrium. I show that unlike in the case of private goods, better informed individuals face positive incentives to incur a cost to share information with their neighbors and that these incentives are stronger and provision of the pure public good greater the smaller are individuals' social neighborhoods.

DIRECTED SEARCH AND THE BERTRAND PARADOX

- International Economic Review---2014---Athanasios Geromichalos

I study a directed search model of oligopolistic competition, extended to incorporate general capacity constraints, congestion effects, and pricing based on ex post demand. In the presence of any one of these ingredients, the Bertrand paradox fails to hold. Hence, despite the emphasis that has been placed by the literature on sellers' capacity constraints as a resolution to the paradox, the existence of such constraints is only a subcase of a general class of environments where the paradox fails. Specifically, Bertrand's paradox will not arise whenever the buyers' expected utility from visiting a seller is decreasing in that seller's realized demand.

PARETO EFFICIENCY AND WEIGHTED MAJORITY RULES

- International Economic Review---2014---Yaron Azrieli,Semin Kim

We consider the design of decision rules in an environment with two alternatives, independent private values and no monetary transfers. The utilitarian rule subject to incentive compatibility constraints is a weighted majority rule, where agents' weights correspond to expected gains given that their favorite alternative is chosen. It is shown that a rule is interim incentive efficient if and only if it is a weighted majority rule, and we characterize those weighted majority rules that are ex ante incentive efficient. We also discuss efficiency in the class of anonymous mechanisms and the stability of weighted majority rules.

KNOWLEDGE ACCUMULATION WITHIN AN ORGANIZATION

- International Economic Review---2014---Ngo Long,Antoine Soubeyran,Raphael Soubeyran

In this article, we consider a knowledge accumulation problem within an organization that cannot prevent the worker from quitting and using the knowledge outside the organization. We show that knowledge accumulation is delayed: The fraction of working time allocated to knowledge creation is highest at the early career stage, falls gradually, then rises again, before falling finally toward zero. We determine the effect of a change in the severity of the enforcement problem (or the specificity of knowledge). We also discuss the form of the optimal life-cycle wage profiles, the role of the initial knowledge level, and the role of discounting.

A STUDY OF PARTICIPATION IN DYNAMIC AUCTIONS

- International Economic Review---2014---Joachim Groeger

This article studies repeated entry and bidding decisions in construction procurement auctions. I find evidence in the data that suggests the presence of significant cost savings from entering contracts of the same type. I estimate a dynamic auction model to measure the gains to experience for bidders. I allow for endogenous entry, synergies in entry, and unobserved auction heterogeneity. I find that a bidder can

halve entry costs by focusing on specific contract types. An auctioneer can increase competition by awarding contracts of the same type in sequence. As a result, procurement costs for each contract can be lowered by 7%, a saving of \$110,000.

MARRIAGE, DIVORCE, AND ASYMMETRIC INFORMATION

- International Economic Review---2014---Leora Friedberg,Steven Stern

We use data on people's valuations of options outside marriage and beliefs about spouses' options. The data demonstrate that, in some couples, one spouse would be happier and the other spouse unhappier outside of some marriages, suggesting that bargaining takes place and that spouses have private information. We estimate a bargaining model with interdependent utility that quantifies the resulting inefficiencies. Our results show that people forgo some utility in order to make their spouses better off and, in doing so, offset much of the inefficiency generated by their imperfect knowledge. Thus, we find evidence of asymmetric information and interdependent utility in marriage.

ENDOGENOUS JOB CONTACT NETWORKS

- International Economic Review---2014---Andrea Galeotti,Luca Merlino

We develop a model where workers, anticipating the risk of becoming unemployed, invest in connections in order to access information about available jobs that other workers may have. The investment in connections is high when the job separation rate in the labor market is moderate, whereas it is low for either low or high levels of job separation rate. The equilibrium response of network investment to changes in the labor market conditions generates novel empirical predictions. In particular, the probability that a worker finds a new job via his connections increases in the separation rate when the separation rate is low, whereas it decreases when the separation rate is high. These predictions are supported by the empirical patterns that we document for the U.K. labor market.

DO “CAPITALIZATION EFFECTS” FOR PUBLIC GOODS REVEAL THE PUBLIC’S WILLINGNESS TO PAY?

- International Economic Review---2014---Nicolai Kuminoff,Jaren Pope

This article develops a welfare theoretic framework for interpreting evidence on the impacts of public programs on housing markets. We extend Rosen’s hedonic model to explain how housing prices capitalize exogenous shocks to public goods and externalities. The model predicts that trading between heterogeneous buyers and sellers will drive a wedge between these “capitalization effects” and welfare changes. We test this hypothesis in the context of changes in measures of school quality in five metropolitan areas. Results from boundary discontinuity designs suggest that capitalization effects understate parents’ willingness to pay for public school improvements by as much as 75%.

TRADE AND DIVERGENCE IN EDUCATION SYSTEMS

- International Economic Review---2014---Pao-Li Chang,Fali Huang

This article presents a theory on the endogenous choice of education policy and the two-way causal relationship between trade and education systems. A country’s education system determines its talent distribution and comparative advantage; the possibility of trade by raising the returns to the sector of comparative advantage in turn induces countries to further differentiate their education systems and reinforces the initial pattern of comparative advantage. Specifically, the Nash equilibrium choice of education systems by two countries interacting strategically are necessarily more divergent than their autarky choices, and yet less than what is socially optimal for the world.

FREE PARKING FOR ALL IN SHOPPING MALLS

- International Economic Review---2014---Kevin Hasker,Eren Inci

We show why a mall provides parking for free and embed the parking costs in the prices of the goods. Essentially, charging a parking fee to risk-averse customers means penalizing them for not finding their desired good. This result holds whether the mall has monopoly power or prices competitively, if there is parking validation, and if there is a trade-off between shopping and parking spaces. It is also the attainable social optimum. The equilibrium lot size is too small, yielding a rationale for minimum parking requirements. However, parking fees may be positive and lots may be too large in urban malls.

TRADE, WAGES, AND PRODUCTIVITY

- International Economic Review---2014---Kristian Behrens,Giordano Mion,Yasusada Murata,Jens Südekum,Jens Suedekum

We develop a general equilibrium monopolistic competition model in which wages, productivity, consumption diversity, and markups respond to trade integration. We structurally estimate the model and simulate the impacts of removing all trade barriers generated by the Canada–U.S. border. Firm selection gets tougher by 8.09% in Canada and by 0.80% in the United States. Markups that consumers face, which are central to welfare, fall by up to 12.11% in Canadian provinces and by up to 2.82% in U.S. states. However, changes in markups measured at the firm level are ambiguous, thus providing a different piece of information.

THE 2013 LAWRENCE R. KLEIN LECTURE: BEHAVIORAL AND DESCRIPTIVE FORMS OF CHOICE MODELS

- International Economic Review---2014---Ariel Pakes

Empirical work on choice models, especially on relatively new topics or data sets, often starts with descriptive, or what is colloquially referred to as “reduced form,” results. Our descriptive form formalizes this process. It is derived from the underlying behavioral model, has an interpretation in terms of fit, and can

sometimes be used to quantify biases in agents' expectations. We consider estimators for the descriptive form of discrete choice models with interacting agents that take account of approximation errors as well as unobservable sources of endogeneity. We conclude with an investigation of descriptive forms for two-period entry models.

DIVERSE ORGANIZATIONS AND THE COMPETITION FOR TALENT

- International Economic Review---2014---Jan Eeckhout,Roberto Pinheiro

We propose a theory of firm production that requires diverse inputs. We show that in a competitive labor market, firms differ in their skill composition. Organizations with higher total factor productivity (TFP) are larger and hire from a broader range of skills. Technological progress leads to an increase of all wages and results in downsizing. Quantifying productivity using our model shows that a constant elasticity of substitution (CES) production function generates unbiased estimates of TFP but biased estimates of marginal product and elasticity of substitution across skills. Our model also generates estimates of the TFP distribution based on CEO compensation alone.

CONSUMPTION AND TIME USE OVER THE LIFE CYCLE

- International Economic Review---2014---Michael Dotsey,Wenli Li,Fang Yang

We incorporate home production in a dynamic general equilibrium model of consumption and savings with illiquid housing and a collateralized borrowing constraint. The calibrated model explains life-cycle patterns of households' time use and consumption of different categories documented from the microdata. It predicts that the interaction of the labor efficiency profile and the home production technology explains households' time use. The resulting income profiles, the endogenous borrowing constraint, and home production account for the initial hump in consumption. The complementarity of home hours, home input, and

housing in home production drives the consumption profiles later in the life cycle.

REPUTATIONAL BIDDING

- International Economic Review---2014---Francesco Giovannoni,Miltiadis Makris

We consider auctions where bidders care about the reputational effects of their bidding and argue that the amount of information disclosed at the end of the auction will influence bidding. We focus on bid disclosure rules that capture all of the realistic cases. We show that bidders distort their bidding in a way that conforms to stylized facts about takeovers/licence auctions. We rank the disclosure rules in terms of their expected revenues and find that, under certain conditions, full disclosure will not be optimal. First-price and second-price auctions with price disclosure are not revenue equivalent and we rank them.

THE POLITICAL ECONOMY OF ENVIRONMENTAL POLICY WITH OVERLAPPING GENERATIONS

- International Economic Review---2014---Larry Karp,Armon Rezai

A two-sector overlapping generations model illuminates the intergenerational effects of a tax that protects an environmental stock. A traded asset capitalizes the economic returns to future tax-induced environmental improvements, benefiting the current asset owners, the old generation. Absent a transfer, the tax harms the young generation by decreasing their real wage. Future generations benefit from the tax-induced improvement in environmental stock. The principal intergenerational conflict arising from the tax is between generations alive at the time society imposes the policy, not between generations alive at different times. A Pareto-improving tax can be implemented under various political economy settings.

DEGREASING THE WHEELS OF FINANCE

- International Economic Review---2014---Aleksander Berentsen,Samuel Huber,Alessandro

Can there be too much trading in financial markets? We construct a dynamic general equilibrium model, where agents face idiosyncratic liquidity shocks. A financial market allows agents to adjust their portfolio of liquid and illiquid assets in response to these shocks. The optimal policy is to restrict access to this market because portfolio choices exhibit a pecuniary externality: Agents do not take into account that by holding more of the liquid asset, they not only acquire additional insurance against these liquidity shocks, but also marginally increase the value of the liquid asset, which improves insurance for other market participants.

FOR-PROFIT SEARCH PLATFORMS

- International Economic Review---2014---Andras Niedermayer,Artyom Shneyerov

We consider optimal pricing by a profit-maximizing platform running a dynamic search and matching market. Buyers and sellers enter in cohorts over time, meet, and bargain under private information. The optimal centralized mechanism, which involves posting a bid-ask spread, can be decentralized through participation fees charged by the intermediary to both sides. The sum of buyers' and sellers' fees equals the sum of inverse hazard rates of the marginal types, and their ratio equals the ratio of buyers' and sellers' bargaining weights. We also show that a monopolistic intermediary in a search market may be welfare enhancing.

HOW MUCH DOES GEOGRAPHY DEFLECT SERVICES TRADE? CANADIAN ANSWERS

- International Economic Review---2014---James Anderson,Catherine A. Milot,Yoto Yotov

We estimate geographic barriers to trade in nine service categories for Canada's provinces from 1997 to 2007 with novel high-quality bilateral provincial trade data. The border directly reduces average provincial trade with the United States relative to interprovincial trade to 2.4% of its borderless level. Incorporating multilateral resistance reduces foreign trade relative to

interprovincial to 0.1% of its frictionless potential. Geography reduces services trade some seven times more than goods trade overall. Surprisingly, intraprovincial (local) trade in services and goods is equally deflected upward, implying that the border increases interprovincial trade much more in services than goods.

CONDITIONAL STOCHASTIC DOMINANCE TESTS IN DYNAMIC SETTINGS

- International Economic Review---2014---Jesus Gonzalo,Jose Olmo

This article proposes nonparametric consistent tests of conditional stochastic dominance of arbitrary order in a dynamic setting. The novelty of these tests lies in the nonparametric manner of incorporating the information set. The test allows for general forms of unknown serial and mutual dependence between random variables and has an asymptotic distribution that can be easily approximated by simulation. This method has good finite-sample performance. These tests are applied to determine investment efficiency between U.S. industry portfolios conditional on the dynamics of the market portfolio. The empirical analysis suggests that Telecommunications dominates the other sectoral portfolios under risk aversion.

IT'S ABOUT TIME: IMPLICATIONS OF THE PERIOD LENGTH IN AN EQUILIBRIUM SEARCH MODEL

- International Economic Review---2014---Ronald Wolthoff

Empirical evidence suggests that transitions between employment states are highly clustered around the first day of each workweek or month. I analyze the effect of this phenomenon by presenting an equilibrium search model in which the period length is a parameter determining the degree of clustering. Infinitesimally short periods result in a continuous-time model with bilateral meetings, whereas longer time periods introduce the possibility of recall or simultaneity of job offers. In this environment, I show that the period length has a profound effect on equilibrium outcomes, including the

unemployment rate, unemployment duration, and the cross-sectional wage distribution.

WHAT CENTRAL BANKERS NEED TO KNOW ABOUT FORECASTING OIL PRICES

- International Economic Review---2014---Christiane Baumeister,Lutz Kilian

Central banks routinely use short-horizon forecasts of the quarterly price of oil in assessing the global and domestic economic outlook. We address a number of econometric issues specific to the construction of quarterly oil price forecasts in the United States and abroad. We show that quarterly forecasts of the real price of oil from suitably designed vector autoregressive models estimated on monthly data generate the most accurate real-time forecasts overall among a wide range of methods, including quarterly averages of forecasts based on monthly oil futures prices, no-change forecasts, and forecasts based on regression models estimated on quarterly data.

MODELING INVESTMENT-SECTOR EFFICIENCY SHOCKS: WHEN DOES DISAGGREGATION MATTER?

- International Economic Review---2014---Luca Guerrieri,Dale Henderson,Jinill Kim

The most straightforward way to analyze investment-sector productivity developments is to construct a two-sector model with a sector-specific productivity shock. An often used modeling shortcut accounts for such developments using a one-sector model with shocks to the efficiency of investment in a capital accumulation equation. This shortcut is theoretically justified when some stringent conditions are satisfied. Using a two-sector model, we consider the implications of relaxing several of the conditions that are at odds with the U.S. Input–Output Tables, including equal factor shares across sectors. The effects of productivity shocks to an investment-producing sector of our two-sector model differ from those of efficiency shocks to investment in a one-sector model. Notably, expansionary productivity shocks boost consumption in every period, whereas

expansionary efficiency shocks cause consumption to fall substantially for many periods.

NONHOMOTHETIC GROWTH MODELS FOR THE ENVIRONMENTAL KUZNETS CURVE

- International Economic Review---2014---Katsuyuki Shibayama,Iain Fraser

We show the role of the elasticity of substitution between general consumption and the environment in environmental degradation. Specifically, our numerical experiments demonstrate, for a wide range of models, exponential utility generates the environmental Kuznets curve without adding any special assumptions. With exponential utility, the elasticity of substitution and hence the substitution effect between consumption and the environment are both decreasing in income. Hence, when income is low, society (the government) readily gives up environmental quality in return for more consumption, but it does not want to substitute consumption for the environment anymore, once it becomes wealthy enough.

DYNAMIC PRICE COMPETITION WITH CAPACITY CONSTRAINTS AND A STRATEGIC BUYER

- International Economic Review---2014---James J. Anton,Gary Biglaiser,Nikolaos Vettas

We analyze a simple dynamic durable good model. Two incumbent sellers and potential entrants choose their capacities at the start of the game. We solve for equilibrium capacity choices and the (necessarily mixed) pricing strategies. In equilibrium, the buyer splits the order with positive probability to preserve competition, making it possible that a high and low price seller both have sales. Sellers command a rent above the value of unmet demand by the other seller. A buyer benefits from either a commitment not to make future purchases or by hiring an agent to always buy from the lowest priced seller.

EFFECTIVE PERSUASION

- International Economic Review---2014---Ying Chen,Wojciech Olszewski

Do elementary statistics or equilibrium theory deliver any insight regarding how we should argue in debates? We provide an answer in a model in which each discussant wants to convince the audience that a specific state holds. If the discussants' payoffs in the audience's posterior are concave above and convex below the prior and exhibit loss aversion, then the leading discussant should give precedence to the weaker argument, and the follower should respond to a weak argument weakly and to a strong argument strongly. Such characterizations are also obtained for the case of choosing between independent and correlated arguments.

CURRENCY VERSUS BANKING IN THE FINANCIAL CRISIS OF 1931

- International Economic Review---2014---Albrecht Ritschl,Samad Sarferaz

During the 1920s, Germany was the world's largest capital importer, financing reparations through U.S. credits. We examine financial channels in crisis transmission between these two countries around the German financial crisis of 1931. We specify a structural dynamic factor model to identify financial and monetary factors separately for each of the two economies. We find substantial crisis transmission from Germany to the United States via the financial channel, while monetary or financial crisis transmission from the United States to Germany was weak. We also find major real effects of the 1931 crisis on both economies, again transmitted via the financial channel.

BUYERS, SELLERS, AND MIDDLEMEN: VARIATIONS ON SEARCH-THEORETIC THEMES

- International Economic Review---2014---Randall Wright,Yuet-Yee Wong

We study exchange that is bilateral but indirect—it involves chains of intermediaries, or middlemen—in markets with frictions. These frictions include search and bargaining problems. We show how, and how many, intermediaries might get involved in a chain, and how bargaining with one depends on upcoming negotiations with those downstream. The roles of buyers, sellers,

money, and prices are discussed, allowing us to clarify some neglected connections between different branches of search theory. Pursuing one such connection, with monetary economics, we show how bubbles can emerge in intermediation, even with fully rational agents and perfect foresight.

A GAME THEORETIC FOUNDATION OF COMPETITIVE EQUILIBRIA WITH ADVERSE SELECTION

- International Economic Review---2014---Nick Netzer,Florian Scheuer

We construct an extensive form game that captures competitive markets with adverse selection. It allows firms to offer any finite set of contracts, so that cross-subsidization is not ruled out. Moreover, firms can withdraw from the market after initial contract offers have been observed. We show that a subgame perfect equilibrium always exists. In fact, when withdrawal is costless, the set of equilibrium outcomes may correspond to the entire set of feasible contracts. We then focus on robust equilibria that continue to exist for small withdrawal costs. We show that the Miyazaki–Wilson contracts are the unique robust equilibrium outcome.

RIGID PRICES: EVIDENCE FROM U.S. SCANNER DATA

- International Economic Review---2014---Jeffrey Campbell,Benjamin Eden

This article uses weekly scanner data from two small U.S. cities to characterize time and state dependence of grocers' pricing decisions. In these data, the probability of a nominal adjustment declines with the time since the last price change. A store's price for a particular product typically goes through several price changes in rapid succession before settling down. We also detect state dependence: The probability of a nominal adjustment is highest when a store's price substantially differs from the average of other stores' prices. However, extreme relative prices typically reflect the store's recent changes instead of changes in average prices.

IRRATIONALITY-PROOFNESS: MARKETS VERSUS GAMES

- International Economic Review---2014---Michael Mandler

How robust are economic models to the introduction of irrational agents? The Pareto efficiency of competitive equilibria is not robust since one irrational agent leads to inefficiency. But the property that rational agents cannot use their own resources to Pareto improve on their competitive allocation holds regardless of the number of irrational agents. Full production efficiency can be robust as well, but irrational firms introduce a trade-off between efficiency and the attainment of Pareto improvements. Regarding games, I show that while existing implementation mechanisms are sensitive to the presence of irrational agents, there are robust alternatives with attractive welfare properties.

KNOWLEDGE AND GROWTH IN THE VERY LONG RUN

- International Economic Review---2014---Holger Strulik

This article proposes a theory for the gradual evolution of knowledge diffusion and growth over the very long run. A feedback mechanism between capital accumulation and the ease of knowledge diffusion explains a long epoch of stasis and an epoch of high growth linked by a gradual economic takeoff. The feedback mechanism can explain the Great Divergence, the failure of less developed countries to attract capital from abroad, and the productivity slowdown. An extension toward a two-region world economy shows robustness of results and other interesting interaction between forerunners and followers of the Industrial Revolution.

OPTIMISM AND PESSIMISM IN GAMES

- International Economic Review---2014---Jürgen Eichberger,David Kelsey

This article considers the impact of ambiguity in strategic situations. It extends the existing literature on games with ambiguity-averse players by allowing for

optimistic responses to ambiguity. We use the CEU model of ambiguity with a class of capacities introduced by Jaffray and Philippe (Mathematics of Operations Research 22 (1997), 165–85), which allows us to distinguish ambiguity from ambiguity-attitude, and propose a new solution concept, equilibrium under ambiguity (EUA), for players who may be characterized by ambiguity-preference. Applying EUA, we study comparative statics of changes in ambiguity-attitude in games with strategic complements. This extends work in Eichberger and Kelsey (Journal of Economic Theory 106 (2002), 436–66) on the effects of increasing ambiguity if players are ambiguity averse.

R&D AND ECONOMIC GROWTH IN A CASH-IN-ADVANCE ECONOMY

- International Economic Review---2014---Angus Chu,Guido Cozzi

R&D investment has well-known liquidity problems, with potentially important consequences. In this study, we analyze the effects of monetary policy on economic growth and social welfare in a Schumpeterian growth model with cash-in-advance (CIA) constraints on R&D investment, consumption, and manufacturing. Our main results can be summarized as follows. Under the CIA constraints on R&D and consumption (the CIA constraint on manufacturing), an increase in the nominal interest rate decreases (increases) R&D and economic growth. We also analyze the optimality of Friedman rule and find that Friedman rule can be sub-optimal due to a unique feature of the Schumpeterian model.

WAGE FLOORS, IMPERFECT PERFORMANCE MEASURES, AND OPTIMAL JOB DESIGN

- International Economic Review---2014---Jenny Kragl,Anja Schöttner

We analyze the effects of wage floors on optimal job design in a moral-hazard model with asymmetric tasks and imperfect aggregate performance measurement. Due to cost advantages of specialization, assigning the tasks to different agents is efficient. A sufficiently high

wage floor, however, induces the principal to dismiss one agent or to even exclude tasks from the production process. Imperfect performance measurement always lowers profit under multitasking, but may increase profit under specialization. We further show that variations in the wage floor and the agents' reservation utility have significantly different effects on welfare and optimal job design.

TEMPORARY EMIGRATION AND WELFARE: THE CASE OF LOW-SKILLED LABOR

- International Economic Review---2014---Slobodan Djajić

This article studies the implications of temporary emigration for the welfare of a source country. The framework is one of general equilibrium, where the economy's stocks of both capital and labor are endogenously determined by the saving and migration decisions of optimizing agents. Simulations of the model suggest that for realistic values of the parameters, welfare of nonmigrants of the source country is maximized when the migrants are employed abroad for a period in the range of roughly 8–12 years. The ideal duration is found to be an increasing function of the international wage differential, migration costs, and the degree to which the rights of migrants are protected in the host country.

LIFE-CYCLE LABOR SEARCH WITH STOCHASTIC MATCH QUALITY

- International Economic Review---2014---Julen Esteban-Pretel,Junichi Fujimoto

In the United States, unemployment, job finding, and separation rates decline as worker age increases. To explain these facts, we build a search and matching model of the labor market that incorporates a life-cycle structure and features random match quality as well as human capital accumulation. The calibrated model successfully reproduces the empirical patterns of unemployment and job transition rates over the life cycle and generates plausible wage implications. We then explore the efficiency implications of the model and find

that the differences between the market and planner allocations are more important for older workers.

WHEN DOES DETERMINACY IMPLY EXPECTATIONAL STABILITY?

- International Economic Review---2014---James Bullard,Stefano Eusepi

Since the introduction of rational expectations, there have been issues with multiple equilibria and equilibrium selection. We study the connections between determinacy of rational expectations equilibrium and learnability of that equilibrium in a general class of purely forward-looking models. Our framework is sufficiently flexible to encompass lags in agents' information and either finite horizon or infinite horizon approaches to learning. We are able to isolate conditions under which determinacy does and does not imply learnability and also conditions under which long-horizon forecasts make a clear difference for learnability. Finally, we apply our result to a relatively general New Keynesian model.

EVOLUTION OF GENDER DIFFERENCES IN POST-SECONDARY HUMAN CAPITAL INVESTMENTS: COLLEGE MAJORS

- International Economic Review---2014---Ahu Gemici,Matthew Wiswall

Although women in the United States now complete more college degrees than men, the distribution of college majors among college graduates remains unequal, with women about two-thirds as likely as men to major in business or science. We develop and estimate a dynamic, overlapping generations model of human capital investments and labor supply. We allow for specific college major choices, instead of aggregating these choices to the education level. Results show that changes in skill prices, higher schooling costs, and gender-specific changes in home value were each important to the long-term trends.

VALUE OF INFORMATION IN COMPETITIVE ECONOMIES WITH INCOMPLETE MARKETS

- International Economic Review---2014---Piero Gottardi,Rohit Rahi

We study the value of public information in competitive economies with incomplete markets. We show that generically the welfare effect of a change in the information available prior to trading can be in any direction: There exist changes in information that make all agents better off and changes for which all agents are worse off. In contrast, for any change in information, a Pareto improvement is feasible, that is, attainable by a planner facing the same informational and asset market constraints as agents. In this sense, the response of competitive markets to changes in information is typically not socially optimal.

NUMERICAL SIMULATION OF NONOPTIMAL DYNAMIC EQUILIBRIUM MODELS

- International Economic Review---2014---Zhigang Feng,Jianjun Miao,Adrian Peralta-alva,Manuel S. Santos,Adrian Peralta-Alva

In this article, we propose a recursive equilibrium algorithm for the numerical simulation of nonoptimal dynamic economies. This algorithm builds upon a convergent operator over an expanded set of state variables. The fixed point of this operator defines the set of all Markovian equilibria. We study approximation properties of the operator. We also apply our recursive equilibrium algorithm to various models with heterogeneous agents, incomplete financial markets, endogenous and exogenous borrowing constraints, taxes, and money.

A SEARCH-EQUILIBRIUM APPROACH TO THE EFFECTS OF IMMIGRATION ON LABOR MARKET OUTCOMES

- International Economic Review---2014---Andri Chassamboulli,Theodore Palivos

We analyze the impact of the U.S. skill-biased immigration influx that took place between 2000 and

2009 within a search and matching model that allows for skill heterogeneity, differential search cost, and capital-skill complementarity. We find that although the skill-biased immigration raised the overall net income to natives, it had distributional effects. Specifically, unskilled native workers gained in terms of both employment and wages. Skilled native workers, however, gained in terms of employment but lost in terms of wages. Nevertheless, in an extension where skilled natives and immigrants are imperfect substitutes, even the skilled wage rises.

GLOBALIZATION, TRADE, AND WAGES: WHAT DOES HISTORY TELL US ABOUT CHINA?

- International Economic Review---2014---Kris James Mitchener,Se Yan

Newly assembled data show that, as China opened up to global trade during the early 20th century, its exports became more unskilled-intensive and its imports more skill-intensive. Difference-in-differences estimates show that World War I dramatically increased Chinese exports, raising the relative demand for the unskilled workers producing them. When the war ended, trade costs declined and China's terms of trade increased, further stimulating exports. A simulation of a dynamic general equilibrium model demonstrates that the effects of the war on China's terms of trade produces a decline in the skill premium similar to what China experienced in the 1920s.

ON FISCAL MULTIPLIERS: ESTIMATES FROM A MEDIUM SCALE DSGE MODEL

- International Economic Review---2014---Sarah Zubairy

This article contributes to the debate on fiscal multipliers, in the context of an estimated dynamic stochastic general equilibrium model, featuring a rich fiscal policy block and a transmission mechanism for government spending shocks. I find the multiplier for government spending to be 1.07, which is largest on impact. The multipliers for labor and capital tax on impact are 0.13 and 0.34, respectively. The effects of tax cuts take time

to build and exceed stimulative effects of spending by 12–20 quarters. I carry out counterfactual exercises to show how alternative financing methods and expected monetary policy have consequences for the size of fiscal multipliers.

EXIT OPTIONS AND DIVIDEND POLICY UNDER LIQUIDITY CONSTRAINTS

- International Economic Review---2014---Pauli Murto,Marko Terviö

We introduce a post-entry liquidity constraint to the standard model of a firm with serially correlated profitability and an irreversible exit decision. We assume that firms with no cash holdings and negative cash flow must either exit or raise new cash at a transaction cost. This creates a precautionary motive for holding cash, which must be traded off against the liquidity cost of holding cash. We characterize the optimal exit and payout policy. The direct effect of financial frictions is to impose inefficient exit, but there is also an indirect effect through higher equilibrium price that leads to inefficient survival.

ECONOMIC GROWTH WITH TRADE IN FACTORS OF PRODUCTION

- International Economic Review---2014---Karine Yenokyan,John Seater,Maryam Arabshahi

We study the world trading equilibrium in a Ricardian model, where factors of production are produced and traded. Even in the absence of technology transfer, international investment, research and development, and aggregate scale effects, trade affects economic growth through comparative advantage. Trade may raise the growth rate or leave it unchanged, depending on the patterns of comparative and absolute advantage. Trade in factors of production can effectively equalize technology even when technology transfer does not occur. Factor price equalization may hold, but the Stolper–Samuelson and Rybczynski theorems do not. The transition dynamics can be monotonic or oscillatory.

ASSET RETURNS UNDER PERIODIC REVELATIONS OF EARNINGS MANAGEMENT

- International Economic Review---2014---Bo Sun

The article investigates stock return dynamics in an environment where executives have an incentive to maximize their compensation by artificially inflating earnings. A principal–agent model with financial reporting and managerial effort is embedded in a Lucas asset-pricing model with periodic revelations of the firm’s underlying profitability. The return process generated from the model is consistent with a range of empirical regularities observed in the return data: volatility clustering, asymmetric volatility, and high idiosyncratic volatility. The calibration results further indicate that earnings management can be quantitatively important in accounting for the dynamic patterns of stock returns.

GROWTH, RENEWABLES, AND THE OPTIMAL CARBON TAX

- International Economic Review---2014---Frederick (Rick) van der Ploeg,Cees Withagen

Optimal climate policy is investigated in a Ramsey growth model of the global economy with exhaustible oil reserves, an infinitely elastic supply of renewables, stock-dependent oil extraction costs, and convex climate damages. Four regimes can occur, depending on the initial social cost of oil being larger or smaller than that of renewables and depending on the initial oil stock being large or small. We also offer some policy simulations for the first and second regime, which illustrate that with a lower discount rate more oil is left in situ and renewables are phased in more quickly. We identify the conditions under which the optimal carbon tax rises or decreases. Subsidizing renewables (without a carbon tax) induces more oil to be left in situ and a quicker phasing in of renewables, but oil is depleted more rapidly initially. The net effect on global warming is ambiguous.

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