Stochastic Growth in the United States and Euro Area

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This paper estimates, using data from the United States and Euro Area, a two-country stochastic growth model in which both neutral and investment-specific technology shocks are nonstationary but cointegrated across economies. The results point to large and persistent swings in productivity, both favorable and adverse, originating in the US but not transmitted to the EA. More specifically, the results suggest that while the EA missed out on the period of rapid investment-specific technological change enjoyed in the US during the 1990s, it also escaped the stagnation in neutral technological progress that plagued the US in the 1970s. (JEL: E32, F41, F43, O41, O47)

Do Financial Incentives Affect Firms' Demand For Disabled Workers?

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A number of OECD countries aim to encourage work integration of disabled persons using quota policies. For instance, Austrian firms must provide at least one job to a disabled worker per 25 non-disabled workers and are subject to a tax if they do not. This "threshold design" provides causal estimates of the non-compliance tax on disabled employment if firms do not manipulate non-disabled employment; a lower and upper bound on the causal effect can be constructed if they do. Results indicate that firms with 25 non-disabled workers employ about 0.04 (or 12%) more disabled workers than without the tax; firms do manipulate employment of non-disabled workers but the lower bound on the employment effect of the quota remains positive; employment effects are stronger in low-wage firms than in high-wage firms; and firms subject to the quota of two disabled workers or more hire 0.08 more disabled workers per additional quota job. Moreover, increasing the non-compliance tax increases excess disabled employment, whereas paying a bonus to over-complying firms slightly dampens the employment effects of the tax. (JEL: E32, J20, J71, J78)

Optimal Contracts with Enforcement Risk

Nicola Gennaioli, CREI and Universitat Pompeu Fabra

I build a model where potentially biased judges verify complex states by interpreting an imperfect signal whose noise captures factual ambiguities. In a sales and a financial transaction I show that judicial biases amplify and distort factual ambiguities, creating enforcement risk. To insure against such risk, parties write simple non-contingent contracts that optimally protect the party that is most vulnerable to judicial error. These results shed light on the empirical association between law and finance and rationalize salient features of real world enforcement regimes. (JEL: D86, K12, G3)

The Basic Public Finance of Public-Private Partnerships

Eduardo Engel, Yale University and NBER, Ronald Fischer, Universidad de Chile, and Alexander Galetovic, Universidad de los Andes

Public-private partnerships (PPPs) have been justified because they release public funds or save on distortionary taxes. However, the resources saved by a government that does not finance the upfront investment are offset by giving up future revenue flows. If a PPP can be justified on efficiency grounds, the PPP contract that optimally balances demand risk, user fee distortions and the opportunity cost of public funds has a minimum revenue guarantee and a revenue cap. The optimal contract can be implemented with a competitive auction with reasonable informational requirements. The optimal revenue guarantees, revenue sharing agreements and auction mechanisms are different from those observed in the real world. In particular, the optimal contract duration is shorter in demand states where the revenue cap binds. These results also have implications for the budgetary accounting of
PPPs, as they show that their fiscal impact resembles that of public provision, rather than privatization. (JEL: H21, H54, L51, R42)

Conditional Investment—Cash Flow Sensitivities and Financing Constraints
Stephen Bond, Nuffield College, Oxford University Institute for Fiscal Studies and Måns Söderbom, University of Gothenburg

We study the sensitivity of investment to cash flow conditional on measures of q in an adjustment costs framework with costly external finance. We present a benchmark model in which this conditional investment-cash flow sensitivity increases monotonically with the cost premium for external finance, for firms in a financially constrained regime. Using simulated data, we show that this pattern is found in linear regressions that relate investment rates to measures of both cash flow and average q. We also derive a structural equation for investment from the first order conditions of our model, and show that this can be estimated directly.

Proxying for Unobservable Variables with Internet Document-Frequency

The internet contains billions of documents. Based on the premise that the occurrence of an event increases its textual frequency, we assess whether document frequencies in large decentralized textual databases can capture the cross-sectional variation in the occurrence frequencies of social phenomena. We characterize the econometric conditions under which such proxying is likely. We also propose using recently-introduced internet search volume indexes as proxies for fundamental locational traits, and discuss their advantages and limitations. We then successfully proxy for a number of economic and demographic variables in US cities and states. We further obtain document- frequency measures of corruption by country and US state and replicate the econometric results of previous research studying its covariates. Finally, we provide the first measure of corruption in American cities. Poverty, population size, service-sector orientation, and ethnic fragmentation are shown to predict higher levels of corruption in urban America. (JEL: H00, J11, C81, B40, D73)

Relative Factor Endowments And International Portfolio Choice
Alejandro Cuñat, University of Vienna and Christian Fons-Rosen, University Pompeu Fabra

We present a model of international portfolio choice based on cross-country differences in relative factor abundance. Countries have varying degrees of similarity in their factor endowment ratios, and are subject to aggregate productivity shocks. Risk averse consumers can insure against these shocks by investing their wealth at home and abroad. In a many-good setup, the change in factor prices after a positive shock in a particular country provides insurance to countries that have dissimilar factor endowment ratios, but is bad news for countries with similar factor endowment ratios, since their incomes will worsen. Therefore countries with similar relative factor endowments have a stronger incentive to invest in one another for insurance purposes than countries with dissimilar endowments. The importance of this effect depends on the size of countries. Empirical evidence linking bilateral international equity investment positions to a proxy for relative factor endowments supports our theory: the similarity of host and source countries in their relative capital-labor ratios has a positive effect on the source country’s investment position in the host country. The effect of similarity is enhanced by the size of host countries. (JEL: F21, F34, G11)
Does Relationship Specific Investment Depend on Asset Ownership? Evidence from a Natural Experiment in the Housing Market

Georg Gebhardt, Ulm University

In this paper, I test the most basic prediction of Grossman and Hart (1986): Allocations of asset ownership that expose a party to ex-post expropriation reduce this party’s ex-ante relationship specific investments. In the empirical context of the German housing market, I find that relationship specific investments, such as bathroom renovations, are more frequent if the occupant is protected against expropriation because he owns his home. To avoid the endogeneity of the homeownership allocation, I rely on the natural experiment of the German reunification: Under the communist regime, ownership existed but was economically meaningless; yet after reunification, ownership unexpectedly reacquired legal force. (JEL: D23, D86, C23)